

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1944

No. 28

CLARIDGE APARTMENTS COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 29

CLARIDGE APARTMENTS COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONS FOR CERTIORARI FILED FEBRUARY 15, 1944.

CERTIORARI GRANTED MARCH 27, 1944.

IN THE
Supreme Court of the United States

OCTOBER TERM, A. D. 1943.

No.

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION,

— *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF
APPEALS FOR THE SEVENTH CIRCUIT.

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TRANSCRIPT OF RECORD

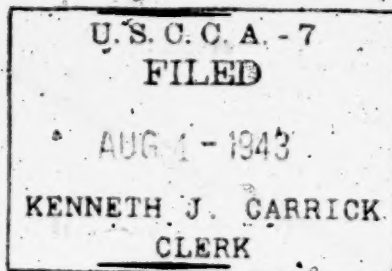
**In the
United States Circuit Court of Appeals
For the Seventh Circuit**

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION,
Petitioner,
No. 8296 *vs.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
No. 8297 *vs.*

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION,
Respondent.



U Petition for Review of Decision of the Tax Court of the
United States.

In the
United States Circuit Court of Appeals
For the Seventh Circuit

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION,

Petitioner,

No. 8296

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

No. 8297

vs.

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION,

Respondent.

Petition for Review of Decision of the Tax Court of the
United States.

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Docket Entries.

1 Claridge Apartments Company, an Illinois Corporation,

Petitioner.

vs.

Commissioner of Internal Revenue,
Respondent.

Docket No. 106868.

Appearances:

For Taxpayer: Walter Hamilton.

For Comm'r: David Altman, George E. Gibson.

DOCKET ENTRIES.

1941

Apr. 11—Petition received and filed. Taxpayer notified. Fee paid.

Apr. 11—Copy of petition served on General Counsel.

Apr. 14—Request for Circuit hearing in Chicago, Illinois, filed by taxpayer. 4 11 41 copy served.

May 29—Answer filed by General Counsel.

June 5—Copy of answer served on taxpayer; Chicago.

1942

Jan. 13—Hearing set Feb. 24, 1942, in Chicago, Illinois.

Feb. 25—Hearing had before Mr. Oppen on merits. Submitted.

Feb. 26—Appearance of Walter Hamilton, Esq., filed. Briefs due 4 13 42. Reply Apr. 28, 1942.

Mar. 13—Transcript of hearing 2 25 42 filed. Pages 1-190, inc.

Mar. 13—Transcript of hearing 2 26 42 filed. Pages 191-231, inc.

Apr. 8—Brief filed by taxpayer.

Apr. 9—Motion for extension to May 13, 1942, to file brief filed by General Counsel. 4 10 42 granted.

May 11—Motion for extension to May 23, 1942, to file brief filed by General Counsel. 5 12 42 granted.

May 23—Brief filed by General Counsel. Copy served 5 25 42.

May 25—Copy of brief served on General Counsel.

June 5—Reply brief filed by taxpayer. 6 5 42 copy served on General Counsel.

Docket Entries.

June 10—Motion for leave to file the attached reply brief, reply brief lodged 6/9/42, filed, by General Counsel. 6/10/42 granted.

Dec. 4—Findings of fact and opinion rendered. Oppen. Decision will be entered under rule 50. Served 12/7/42.

1943

Jan. 1—Consent to settlement filed by taxpayer.

Jan. 4—Agreed computation of deficiency filed.

Jan. 5—Copy of consent served on General Counsel.

2 Jan. 9—Decision entered. Clarence V. Oppen, Div.

14.

Mar. 26—Petition for review by U. S. Circuit Court of Appeals, 7th Circuit, and statement of points filed by taxpayer.

Mar. 26—Notice of filing petition for review and statement of points sent to General Counsel filed.

Mar. 27—Proof of service filed.

Mar. 30—Petition for review by U. S. Circuit Court of Appeals, 7th Circuit, filed by General Counsel.

Mar. 30—Statement of points filed by General Counsel.

Mar. 30—Notice of filing petition for review and statement of points to Walter Hamilton filed.

Apr. 3—Proof of service filed.

Apr. 3—Certified copy of order from 7th Circuit requesting Exhibit No. 2 and No. 11 not be printed but considered part of the record and Tax Court to hold said exhibits until 10 days before this cause is argued, filed.

Apr. 10—Proof of service of filing petition for review and statement of points filed by General Counsel.

Apr. 10—Agreed statement of evidence filed.

Apr. 10—Joint designation of contents of record filed.

Apr. 12—Certified copy of order from the 7th Circuit re consolidation and decision upon a single consolidated transcript of record, consisting of such portions of the record made before the Tax Court as the parties herein may indicate by their joint designation, omitting any repetition of documents filed.

Apr. 16—Agreed statement of evidence approved and ordered filed.

PETITION.

(Filed April 11, 1941.)

The above named Petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue, in his notice of deficiency from the office of Internal Revenue in charge, Chicago Division, Room 1100, 105 West Adams Street, Chicago, Illinois, dated January 17, 1941, and as a basis of its proceeding alleges as follows:

1. The Petitioner is a corporation organized and existing under and by virtue of the laws of the State of Illinois with its principal office at 29 South La Salle Street, Chicago, Illinois. The returns for the periods herein involved were filed with the Collector of Internal Revenue for the district of Chicago, Illinois.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit 'A'") was mailed to Petitioner January 17, 1941.

3. The taxes in controversy are income and excess profits taxes for the calendar years of 1935, 1936, 1937, and 1938 and in the amount of \$3,289.74 income taxes and \$67.85 excess profits taxes.

4. The determination of the tax set forth in the said notice of deficiency is based upon the following errors:

(a) The depreciation allowed to be deducted for the year 1935 was \$2,234.98, whereas, the amount of depreciation in the tax return of \$13,293.78 should have been allowed.

(b) The basis of the depreciation allowed for the calendar years 1935, 1936, 1937, and 1938 was the alleged market value of the property on the date it was acquired, August 1, 1935, whereas, the basis for such depreciation that should have been allowed was the basis of the cost of the building in 1924 to Claridge Building Corporation, the predecessor in title of Petitioner.

(c) The Internal Revenue Department of the United States erred in not holding that Petitioner took title in a tax free reorganization under the Internal Revenue's laws of the United States and was entitled to take as a basis for

depreciation the cost of the property to its predecessor in title.

(d) The Internal Revenue Department fixed the sum of \$132,500 as the fair cash market value of the apartment building on date of its acquisition by Petitioner whereas such value on that date was the sum of \$230,580.

(e) The Internal Revenue Department erred in allowing only the sum of \$5,580 as depreciation for the building for the calendar year of 1936 whereas it should have allowed the sum claimed in the return of \$14,071.48.

(f) The Internal Revenue Department erred in allowing only the sum of \$5,580 as depreciation of the building for the calendar year of 1937 whereas it should have allowed the sum claimed in the return of \$14,040.81.

(g) The Internal Revenue Department erred in allowing only the sum of \$5,755.07 as depreciation of the building for the calendar year of 1938 whereas it should have allowed the sum claimed in the return of \$12,913.35.

(h) The Internal Revenue Department erred in not allowing the sum of \$1,681.04 for painting and decorating and repairs as a deduction on the return of the taxpayer for the year ending December 31, 1937 and in disallowing the same and in not allowing a total sum of \$4789.41 for painting and decorating as a deduction for that taxable year and a total sum of \$1819.37 for repairs and maintenance for that year as claimed by the taxpayer.

5. The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

(a) Claridge Building Corporation, an Illinois Corporation, was the owner of the building and lots known as 5 4501 Malden Street, Chicago, Illinois on March 25, 1924. The building is of brick, built in 1924 at a cost of \$424,609.19 with an estimated life of thirty-three and one-third years and consists of twenty-six, three room apartments, eighty, two room apartments and four shops and approximately 81,345 cubic feet.

(b) On March 25, 1924, 6½% first mortgage bonds in the principal amount of \$340,000 were issued and sold, secured by a first mortgage or trust deed on said premises. On September 9, 1931 said bonds had been paid except for \$277,000 principal amount then outstanding. On October 1, 1931 the Trustees of the bond issue filed his bill to foreclose the mortgage. A decree of foreclosure was entered on February 19, 1932 but no sale was had under the decree.

(c) On September 9, 1931 a committee, known as the

Claridge Apartments First Mortgage Bondholders' Committee, was organized under a deposit agreement of that date.

(d) On June 16, 1934, the said Claridge Building Corporation filed its petition in the District Court of the United States for the Northern District of Illinois, Eastern Division as case ~~56230~~ for a reorganization of said property under Section 77B of the Federal Bankruptcy Act as amended.

(e) A plan of reorganization in such case was submitted on November 27, 1934 by said Claridge Apartments First Mortgage Bondholders' Committee, said Minnie H. Case and said Claridge Building Corporation. The said Committee then had on deposit under said agreement \$258,600 face value of the total of \$277,000 said first mortgage bonds or approximately 93% thereof, the holders of which through said Committee consented and voted for the plan of reorganization. Minnie H. Case was the title holder of said premises for the use and benefit of said Claridge Building Corporation.

(f) Said plan of reorganization as modified was approved and confirmed by the court by final decree entered in said case on the 14th day of May, 1935. By said plan as approved and confirmed by the court the Petitioner was organized under the laws of the State of Illinois with a capital stock consisting of 3,080 common shares without par value. Minnie H. Case owned then 198 shares,

Howard D. Henry owned one share and Albert A. Henry one share of said Claridge Building Corporation. All the stockholders of Claridge Building Corporation consented to and voted for said plan. No creditor voted against it. There were no creditors except for taxes, or foreclosures and reorganization expenses which were all paid. Minnie H. Case and said Claridge Building Corporation conveyed title to said premises to Petitioner, August 1, 1935.

(g) 2,770 of said shares of Petitioner or 90% thereof, were issued to three trustees appointed by the Court for the holders of \$277,000 par value of bonds. All bondholders received or were authorized to receive trust certificates. Each certificate was for one share for each \$100 of bonds held by each bondholder. The balance of the said shares or 308 were issued to Minnie H. Case or her nominee or ten per cent thereof, Case receiving 300 shares and one Charles F. Henry 8 shares all under the plan of reorgani-

Petition.

zation. Two shares remained unissued. The Trustees held the shares under a ten year trust which was terminated at the end of two years and the shares issued to the bondholders, applying one share for each trust certificate, representing \$100 face value of bonds. The trust deed was released and the bonds cancelled by order of court.

(h) All expenses of reorganization, back taxes and claims were paid by Petitioner and for that purpose a first mortgage of \$18,500 was placed on said premises by Petitioner. Petitioner assumed all obligations of the old corporation, of the trustee under the trust deed who was in possession and all claims allowed in the case. The balance of such expenses and claims were paid in cash.

(i) Petitioner was incorporated under the laws of the State of Illinois on May 28, 1935 and took title to said premises under the plan of reorganization on August 1, 1935.

(j) The fair market value of said building on said premises on August 1, 1935 was the sum of \$230,580.

Wherefore, the Petitioner prays that the Board may hear the proceedings and redetermine the deficiency set forth by the Commissioner of Internal Revenue in said notice of deficiency and enter a finding and judgment of no tax due from Petitioner to the respondent.

Claridge Apartments Company,
by Walter Hamilton,

Secretary.

29 South La Salle Street
Chicago, Illinois

State of Illinois }
County of Cook } ss.

Walter Hamilton, being first duly sworn on oath, says that he is the secretary of Claridge Apartments Company, the Petitioner above named, and is duly authorized to verify the foregoing Petition; that he has read the foregoing Petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief and those he believes to be true.

Walter Hamilton.

Subscribed and sworn to before me this 9th day of April, A. D. 1941.

(Seal)

Arthur Chittick,
Notary Public.

Exhibit A.

7

EXHIBIT "A"

TREASURY DEPARTMENT
Internal Revenue Service
Chicago, Illinois

Office of Internal Revenue Agent
in Charge, Chicago Division.
Room 1100, 105 West Adams Street

January 17, 1941

Claridge Apartments Company,
29 South La Salle Street,
Chicago, Illinois.

Sirs:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1935, 1936, 1937 and 1938 discloses a deficiency of \$3,289.74 and that the determination of your excess-profits tax liability for the years mentioned discloses a deficiency of \$67.85 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Chicago, Illinois for the attention of S.N.I.T. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

Guy T. Helvering,
Commissioner.

By (signed) E. C. Wright
Internal Revenue Agent in Charge.

Enclosures:

Statement, Form of Waiver
Form 272M.

Exhibit A.

Statement

SX:IT

Claridge Apartments Company,
29 South La Salle Street,
Chicago, Illinois.

Tax Liability for the Taxable Years Ended December 31,
1935, 1936, 1937 and 1938

Income Tax

Year	Liability	Assessed	Deficiency
1935	\$ 844.39	\$None	\$ 844.39
1936	706.92	None	706.92
1937	752.76	None	752.76
1938	1,348.68	363.01	985.67
Totals	\$3,652.75	\$363.01	\$3,289.74

Excess-profits Tax

1935	\$ 57.05	\$None	\$ 57.05
1938	10.80	None	10.80
Totals	\$ 67.85	\$None	\$ 67.85

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the report of examination dated January 30, 1940; to your protest dated March 6, 1940; and to the statements made at the conferences held on March 26, 1940; May 20, 1940; July 9, 1940 and October 11, 1940.

If you do not acquiesce in all of the adjustments making up the deficiencies indicated, but desire to stop the accumulation of interest on that part of the deficiencies resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiencies you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiencies.

Exhibit A.

9

10 Taxable Year Ended December 31, 1935

Adjustments to Net Income

Net loss as disclosed by return.....	\$ 6,425.18
Unallowable deductions and additional income	
(a) Depreciation	\$10,968.80
(b) Taxes	1,597.42 12,566.22
Net income adjusted.....	\$ 6,141.04

Explanation of Adjustments

(a) The deduction claimed in your return in the amount of \$13,293.78 as depreciation has been adjusted to \$2,324.98 and the sum of \$10,968.80 has been disallowed as excessive depreciation. It has been determined that your basis for depreciation on the apartment building was the fair market value of the property on the date you acquired it, August 1, 1935, or \$132,500. Your basis for the furniture and fixtures has been determined to be the fair market value thereof on the date of acquisition, August 1, 1935, or \$1,400. The remaining life of the apartment building at the date of acquisition was twenty-five years, and the remaining life of the furniture and fixtures was five years. Accordingly, the following schedule shows the depreciation adjustments in accordance with the determinations made herein:

Depreciable Property	Date acquired	Adjusted Cost of Property	Depreciation Rate	Depreciation Allowable
Apartment building	8-1-35	\$132,500	4%	\$ 2,208.33
Furniture and Fixtures	8-1-35	1,400	20%	116.65
Total				\$ 2,324.98
Amount deducted per return				13,293.78

Excessive depreciation disallowed..... \$10,968.80

11 (b) The following taxes have been adjusted to the amounts accrued and deductible during the taxable

Exhibit A.

year under the provisions of section 23(c) of the Revenue Act of 1934:

	Amount Claimed	Amount allowable
Personal property tax.....	\$ 100.47	\$ None
Real estate Tax.....	1,736.95	None
Federal capital stock tax.....	None	240.00
Totals	\$1,837.42	\$ 240.00
Amount allowable	240.00	
Increase in income.....	\$1,597.42	

The real estate and personal property taxes were assessed prior to your organization, and since article 23(c)-1 of Regulations 86, interpreting section 23(c) of the Revenue Act of 1934, provides that taxes are deductible only by the person upon whom they are imposed, no deduction may be allowed.

A credit of \$5,000.00 representing 12 1/2% of the declared value of your capital stock for the year ended June 30, 1935, has been allowed in computing your excess-profits tax liability.

Computation of Tax

Net income as adjusted.....	\$6,141.04
Less:	
Interest on Liberty Bonds, etc.....	None
Balance subject to income tax.....	\$6,141.04
Income Tax at 13 $\frac{1}{4}$ %.....	844.39
Less:	
Taxes paid to a foreign country.....	None
Total income tax.....	\$ 844.39
Income tax assessed:	
Original 1936 list, account No. 864084.....	None
Deficiency of income tax.....	\$ 844.39
Net income for excess-profits tax computation	6,141.04
12 Less:	
12 $\frac{1}{2}$ % of \$40,000.00, value of capital stock as declared in your capital stock tax return for year ended June 30, 1935.....	\$5,000.00
Amount subject to excess-profits tax.....	\$1,141.04
Excess-profits tax 5% of \$1,141.04.....	\$ 57.05
Excess-profits tax assessed:	
Original 1936 list, account No. 864084.....	None
Deficiency of excess-profits tax.....	\$ 57.05

Taxable Year Ended December 31, 1936

Adjustments to Net Income

Net loss as disclosed by return.....	\$1,091.80
Unallowable deductions and additional income	
(a) Depreciation.....	8,491.48
Total.....	\$7,399.68
Nontaxable income and additional deductions	
(b) Taxes.....	427.72
Net income adjusted.....	\$6,971.96

Explanation of Adjustments

(a) The deduction claimed in your return in the amount of \$14,071.48 as depreciation has been adjusted to \$5,580.00 and the sum of \$8,491.48 has been disallowed as excessive depreciation. It has been determined that your basis for depreciation on the apartment building was the fair market value of the property on the date you acquired it, August 1, 1935, or \$132,500. Your basis for the furniture and fixtures has been determined to be the fair market value thereof on the date of acquisition, August 1, 1935, or \$1,400. The remaining life of the apartment building at the date of acquisition was twenty-five years, and the remaining life of the furniture and fixtures was five years. Accordingly, the following schedule shows the depreciation adjustments in accordance with the determinations made herein:

Depreciable Property	Date acquired	Adjusted Cost of Property	Depreciation Date	Depreciation Allowable
Apartment building	8 1 35	\$132,500	4%	\$ 5,300.00
Furniture and Fixtures	8 1 35	1,400	20%	280.00
Total				\$ 5,580.00
Amount deducted per return				14,071.48
Excessive depreciation disallowed				\$ 8,491.48

(b) The taxes shown below have been adjusted under the provisions of section 23(c) of the Revenue Act of 1936, as follows:

	Amount Claimed	Amount Allowable
(1) Real estate tax	\$4,399.02	\$4,842.39
Personal property tax	14.02	42.27
Totals	\$4,413.94	\$4,884.66
Amount claimed		4,413.94
Decrease in income		\$ 470.72

(2) Income has been increased under the provisions of section 23(c) of the Revenue Act of 1936 by the amount of \$43.00 which represents excessive capital stock tax deducted in 1936 as computed below:

Declared value for year ended June 30, 1936, per return	\$200,000.00
Add: Adjusted net income, year 1936	6,971.96

Total	\$206,971.96
Deduct: Dividend distributions (1936)	14,620.50

Adjusted declared value, June 30, 1937	\$192,351.46
Capital stock tax liability accruable	\$ 192.00
Capital stock tax claimed	235.00

Increase in income	\$ 43.00
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These two adjustments result in a net decrease in income of \$427.72.

14.

Exhibit A.

Computation of Tax

Income Tax

Normal Tax:

Taxable net income.....\$6,971.96

14 Less:

Excess-profits tax (paid or accrued).....None

Net income for normal tax computation.....\$6,971.96

Less:

Interest on U. S. obligations.....None

Normal tax net income.....\$6,971.96

8% of \$2,000.00 (Over 0 to \$ 2,000) \$ 160.00

11% of \$4,971.96 (Over \$2,000 to \$15,000) 546.92

Total normal tax.....\$ 706.92

Surtax on Undistributed Profits:

Taxable net income.....\$6,971.96

Less:

Excess-profits tax (paid or accrued).....\$ None

Normal tax \$ 706.92 706.92

Adjusted net income.....\$6,265.04

Less:

Dividends paid credit.....\$14,620.50

Undistributed net income.....\$ None

Total surtax.....\$ None

Normal tax 706.92

Total income tax (normal tax and surtax).....\$ 706.92

Less:

Foreign tax credit.....None

Balance of tax assessable.....\$ 706.92

Income tax assessed (normal tax and surtax):

Original 1937 list, account No. 863382.....None

Deficiency of income tax.....\$ 706.92

Taxable Year Ended December 31, 1937

Adjustments to Net Income

Net loss as disclosed by return.....	\$ 3,262.36	
Unallowable deductions and additional income:		
(a) Painting and decorating; repairs	\$1,681.04	
(b) Taxes	509.20	
(c) Depreciation	8,460.81	10,651.05
Net income adjusted.....	\$ 7,388.69	

15 Explanation of Adjustments

(a) The deductions, claimed in the return for painting and decorating in the amount of \$1,291.44 and for repairs in the amount of \$389.60, have been disallowed since they do not constitute ordinary and necessary business expenses paid or incurred during the taxable year within the meaning of section 23(a) of the Revenue Act of 1936. The expenses disallowed herein were incurred during the year 1936 and were claimed as a deduction in your 1936 return.

(b) The following taxes have been adjusted to the amounts accrued and deductible during the taxable year under the provisions of section 23(c) of the Revenue Act of 1936:

	Amount Claimed	Amount Allowable
Real estate tax	\$4,997.44	\$4,582.74
Personal property tax	50.00	40.50
Federal capital stock tax	185.00	100.00
Totals	\$5,232.44	\$4,723.24
Amount allowable	4,723.24	
Increase in income	\$ 509.20	

(c) The deduction claimed in your return in the amount of \$14,040.81 as depreciation has been adjusted to \$5,580.00 and the sum of \$8,460.81 has been disallowed as excessive

Exhibit A.

depreciation. It has been determined that your basis for depreciation on the apartment building was the fair market value of the property on the date you acquired it, August 1, 1935, or \$132,500. Your basis for the furniture and fixtures has been determined to be the fair market value thereof on the date of acquisition, August 1, 1935, or \$1,400. The remaining life of the apartment building at the date of acquisition was twenty-five years, and the remaining life of the furniture and fixtures was five years. Accordingly, the following schedule shows the depreciation adjustments in accordance with the determinations made herein:

Depreciable Property	Date Acquired	Adjusted Cost of Property	Depreciation Date	Depreciation Allowable
Apartment Building	8 1 35	\$132,500	4%	\$ 5,300.00
Furniture and fixtures	8 1 35	1,400	20%	280.00
Total				\$ 5,580.00
Amount deducted per return				14,040.81
Excessive depreciation disallowed				\$ 8,460.81
The dividends paid credit allowable under the provisions of section 27 of the Revenue Act of 1936 has been recomputed as follows:				
16 Dividends paid during the taxable year				\$ 5,386.50
Dividend carry-over (\$14,620.50 - \$6,265.04)				8,355.46
Total revised credit				\$13,741.94

Computation of Tax

Income Tax		
Normal Tax:		
Taxable net income	\$ 7,388.69	
Less:		
Excess-profits tax (paid or accrued)	None	
Net income for normal tax computation	\$ 7,388.69	
Less:		
Interest on U. S. obligations	None	
Normal tax net income	\$ 7,388.69	
8% of \$2,000.00 (Over 0 to \$ 2,000)	160.00	
11% of \$5,388.69 (Over \$2,000 to \$15,000)	592.76	
Total normal tax	\$ 752.76	
Surtax on Undistributed Profits:		
Taxable net income	\$ 7,388.69	
Less:		
Excess-profits tax (paid or accrued)	\$ None	
Normal tax	752.76	752.76
Adjusted net income	\$ 6,635.93	
Less:		
Dividends paid credit	13,741.96	
Undistributed net income	\$ None	
Total surtax	\$ None	
Normal tax	752.76	
Total income tax (normal tax and surtax)	\$ 752.76	
Less:		
Foreign tax credit	None	
Balance of tax assessable	\$ 752.76	
Income tax assessed (Normal tax and surtax):		
Original 1938 list, account No. 850894	None	
Deficiency of income tax	\$ 752.76	

17 Taxable Year Ended December 31, 1938

Adjustments to Net Income

Net income as disclosed by return	\$ 2,904.11
Unallowable deductions and additional income	
(a) Taxes	\$ 117.53
(b) Depreciation	7,158.28
Net income adjusted	\$10,179.92

Explanation of Adjustments

(a) The real estate and personal property taxes have been adjusted to the amounts accrued and deductible during the taxable year under the provisions of section 23(c) of the Revenue Act of 1938. Computation of the adjustment is as follows:

	Amount Claimed	Amount Allowable
Real estate tax	\$4,906.72	\$4,787.46
Personal property tax	38.77	40.50
Totals	\$4,945.49	\$4,827.96
Amount allowable	4,827.96	
Increase in income	\$ 117.53	

(b) The deduction claimed in your return in the amount of \$12,913.35 as depreciation has been adjusted to \$5,755.07 and the sum of \$7,158.28 has been disallowed as excessive depreciation. It has been determined that your basis for depreciation on the apartment building was the fair market value of the property on the date you acquired it, August 1, 1935, or \$132,500. Your basis for the furniture and fixtures has been determined to be the fair market value thereof on the date of acquisition, August 1, 1935, or \$1,400. The remaining life of the apartment building at the date of acquisition was twenty-five years, and the remaining life of the furniture and fixtures was five years. Accord-

Exhibit A.

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ingly, the following schedule shows the depreciation adjustments in accordance with the determinations made herein:

Depreciable Property	Date Acquired	Adjusted Cost of Property	Depreciation Date	Depreciation Allowable
Apartment building	8/1/35	\$132,500	4%	\$ 5,300.00
Furniture and Fixtures	8/1/35	1,400	20%	280.00
Refrigeration Equipment	1938	4,919.64 (as claimed)		175.07
Total				\$ 5,755.07
Amount deducted per return				12,913.35
Excessive depreciation disallowed				\$ 7,158.28

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Computation of Tax

Excess-profits Tax:

Taxable net income.....\$10,179.92

Less:

10% of \$100,000.00 value of capital stock as
declared in your capital stock tax return
for year ended June 30, 1938.....\$10,000.00

Net income subject to excess-profits tax.....\$ 179.92

5% of declared value of capital stock.....\$ 5,000.00

Balance.....\$ None

Excess-profits tax:

6% of \$179.92.....\$ 10.80

Total excess-profits tax.....\$ 10.80

Excess-profits tax assessed:

Original 1939 list, account No. 420125.....None

Deficiency of excess-profits tax.....\$ 10.80

Income Tax:

Taxable net income.....\$10,179.92

Less:

Excess-profits tax.....10.80

Adjusted net income.....\$10,169.12

Less:

Dividends received credit.....None

Special class net income.....\$10,169.12

Income Tax:

12 1/2% of \$5,000.00 (Not in excess of \$5,000.00).....\$ 625.00

14 % of \$5,169.12 (In excess of \$5,000.00 and
Not in excess of \$20,000.00).....723.68

Total income tax.....\$ 1,348.68

Less:

Taxes paid to a foreign country.....None

Balance of tax assessable.....\$ 1,348.68

Income tax assessed:

Original 1939 list, account No. 420125.....363.01

Deficiency of income tax.....\$ 985.67

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UNITED STATES BOARD OF TAX APPEALS.

(Caption—106868)

Filed
May 29,
1941.

ANSWER TO PETITION.

(Filed May 29, 1941.)

Comes now the Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled cause, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar years 1935, 1936, 1937 and 1938, and excess-profits taxes for the years 1935 and 1938. Denies all other allegations contained in paragraph 3 of the petition.

4 (a) to (h) inclusive. Denies each and every allegation of error contained in subparagraphs (a) to (h) inclusive of paragraph 4 of the petition.

5 (a). Denies the allegations contained in subparagraph (a) of paragraph 5 of the petition, except it is admitted that the Claridge Building Corporation, an Illinois Corporation, was the owner of a brick building and lots in 1924 in Chicago, Illinois.

20 5 (b), (c) and (d). Admits the allegations contained in subparagraphs (b), (c) and (d) of paragraph 5 of the petition.

5 (e). Denies the allegations contained in subparagraph (e) of paragraph 5 of the petition except it is admitted that a plan of reorganization in such case was submitted in 1934.

5 (f). Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition except it is admitted that said plan of reorganization as modified was approved and confirmed by the court by final decree entered in said case in 1935; that petitioner was organized under the laws of the State of Illinois; that the capital stock consisted of 3,080 common shares without par value; and that title to the premises mentioned was conveyed to petitioner on August 1, 1935.

5 (g). Admits the allegations contained in subparagraph (g) of paragraph 5 of the petition.

Statement of Evidence.

5 (h). Denies the allegations contained in subparagraph (h) of paragraph 5 of the petition.

5 (i). Admits the allegations contained in subparagraph (i) of paragraph 5 of the petition.

5 (j). Denies the allegations contained in subparagraph (j) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

21 Wherefore, it is prayed that the Board redetermine the petitioner's liability herein to be the amount determined by the Commissioner, viz.: income tax for the taxable years ending December 31, 1935, 1936, 1937 and 1938, \$3,289.74; excess profits tax for the taxable years ending December 31, 1935 and 1938, \$67.85.

(Signed) J. P. Wenchel,

DAT

J. P. Wenchel,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

F. R. Shearer,

Division Counsel.

David Altman,

Special Attorney.

Bureau of Internal Revenue.

BEFORE THE TAX COURT OF THE UNITED STATES.

(Caption—106868)

STATEMENT OF EVIDENCE IN NARRATIVE FORM.

(Filed Apr. 10, 1943 Apr. 16, 1943.)

The above entitled cause came on for hearing at 1212 Lake Shore Drive, Chicago, Illinois, before the Honorable Clarence V. Oppen, member of the Tax Court of the United States, on February 25, 1942, at 11:30 o'clock A. M., and Walter Hamilton, 29 South LaSalle Street, Chicago, Illinois, appeared on behalf of the Petitioner, and David Altman and George E. Gibson appeared for the Commissioner of Internal Revenue, respondent.

Thereupon the following proceedings were had, and the parties by their attorneys submitted the following evidence:

*Mr. Hamilton: We claim there was a reorganization within the meaning of Section 112 (g) (B) of the 1934 act, in that there was acquisition by one corporation in exchange solely for all or part of its voting stock all the property of another corporation, and that therefore they were entitled to use for depreciation in their income tax, the cost price of the building, which was something over \$424,000, as depreciated.

The Government claims that they were not entitled to that basis. They say it was not a reorganization within the meaning of the act, or they have some other theory, I believe, about the Chandler Act, that the basis should be the fair cash value as of the date of transfer which was August 1, 1935. That is the main basis of the dispute here.

Mr. Altman: It is stipulated that the Petitioner did not acquire the property until August, 1935, but took depreciation for the whole year 1935, when it was entitled to depreciation for only a five month period.

23. Mr. Altman: Our first defense is that the reorganization which transpired in 1935 does not meet the requirements of the Act to qualify as a non-taxable reorganization. Our second is, even if the Board should determine that this reorganization met the statutory requirement in Section 112(g)(1)(B), the correct basis for depreciation under the statute is market value at the date of acquisition, for this reason. As your Honor knows, Section 270 of the Chandler Act provided that whenever a corporation has been reorganized under the provisions of the Bankruptcy Act and in the process of that reorganization its debts are scaled down or cancelled, then the basis of the property in the hands of the old company, if that is the resulting company, or a new one, if a new one is formed, the old basis would be reduced by the amount of the cancelled debt. That section of the Bankruptcy Act was amended in 1939 or 1940 to provide that in no event should the basis arrived at by subtracting the cancelled debts be below market value. So we think market value is the correct basis, either under the theory of a taxable reorganization or under the theory of a non-taxable reorganization, with a cancellation of

the bonded indebtedness which is what the evidence will show.

Mr. Hamilton: I don't think that Chandler Act has anything to do with this case. The Chandler Act as finally amended was back in 1940. You are claiming back to 1935. We claim, in fact offer to show any such change in the law to make it retroactive back for five years is against the Fifth Amendment to the Constitution, as arbitrary and discriminatory and almost fraudulent, and we claim this Section 270 of the Chandler Act is not stated to be retroactive, it has no application in this case, but only to cases that follow in 1940.

Whereupon CHARLES F. HENRY, in witness on behalf of the Petitioner, was duly sworn and testified as follows:

My name is Charles F. Henry, my permanent address is Edgewater Beach Hotel. My business is Real estate and building and managing real estate.

Deficiency Notice, dated January 17, 1941 attached to the Petition as Exhibit A was offered and received in evidence as PETITIONER'S EXHIBIT 1. Its contents are set forth in Petitioner's Petition which is a part of this record.

24 Mr. Henry: The building in question is situated at 4501 Malden Street, Chicago, Illinois. The Claridge Apartments Company, the petitioner, owned in 1935, 1936, 1937, and 1938 the lot at that address with the building on it and some furniture. I built the building on behalf of Claridge Building Corporation, it was corporation organized under the laws of Illinois.

I built the building for the corporation. They obtained title to the land of the building before the building was completed. The corporation paid the bills for the building. It was built in 1924. It was started in the spring, about March, I believe.

"Q. And what was the cost, the total cost of the building after its completion?"

"Mr. Altman: I object to that question on the grounds it has not been shown this witness knows cost, and also it is not the best evidence of the cost. The best evidence of the cost would be the bills that were paid or any other

documents evidencing what the corporation paid for the building.

"The Court: This witness has testified he himself built the building. The best evidence of cost is the knowledge of a witness who has knowledge of it. Records are merely evidence of a recording that was made at the time of something that is a fact. In the absence of any records, if this witness knows, I will let him answer. Objection overruled.

"Mr. Altman: Exception.

"Q. (By Mr. Hamilton.) What was the cost?

"The Court: If he knows.

"Q. (By Mr. Hamilton.) Do you know?

"A. I do know.

"Q. What was the cost?

"A. You mean including the general contractor's profit, or without?

"Q. I want the total cost, profit and everything.

"A. It was four hundred twenty-four thousand and I believe six hundred nineteen and some cents.

"Q. 609.19?

"A. Yes, sir.

Mr. Henry: I know this was the cost at that time because I bought all of the materials and saw all the money was paid for the materials, the labor, and so on, and equipment, everything that went into the property. I made a record at the time.

25 The witness was shown a document which was marked Petitioner's Exhibit 2 for identification and examined it.

Mr. Henry: The book was kept in my own handwriting. This is a record showing contractors, laborers, mechanics and so forth who worked on this property; also shows the material and equipment which was purchased or who purchased it, gives date of payment to the different contractors, material and equipment people. In the front it is alphabetical and that is a simple ledger.

Then starting on page 1, that is the daily cash book showing money paid to the different people connected with the construction of this property. Each entry was made at the time the money was paid or check was drawn for the different items.

From the book here, the records show the total cost, not including the general contractor's profit, of \$385.

169.15. Then adding 10 percent general contractor's profit makes a total of \$423,686.06. Now, the total cost as has been shown each year in the Federal income tax report was a little more than this. At the time by bookkeeper took this record here and totalled it, there is a few other items that I can find to make up the difference there. I find some here, a couple of sheets here that show items of work done, such as odds and ends. There was shops in the building at the time, and one was rented for a beauty parlor. They put in some extra plumbing and gas fittings and so on. There is quite a little of that work done, a lot of odds and ends to be done in a building of that size.

Now some of those items evidently are not in here. I find on different pages different items of cost were not figured in. So I went over that hurriedly last night and saw it would total the amount that was recorded.

These items were put down, as I said before, at the time they were paid out, dating back to February 5, 1924. This book was in storage. I found it at the Claridge Apartments, 4501 Malden, and last night was the first time I had seen this book since the building was finished. At the time the first income tax report was made, the bookkeeper, with my assistance, made it out and \$424,609.19 was the correct cost of the property, and I was unable to find the bookkeeper's statement how he got this little difference, but checking this over, I believe I can show him where the differences are. That cost price was used in the income tax report for 1925 down to date.

There were never any objections made by the Government in regard to it (this cost).

There are one hundred and six apartments consisting of what we call two and a half and three and a half room apartments. The two and a half room apartment we call a living room with inner door bed and dinette and kitchenette. The kitchenette is almost a full sized kitchen. The three and one half room apartment is the same unit with a bed room in addition to that. Of course, each one had a bath room and large dressing closet, large enough for the people to dress in. I think there are twenty six 3 1/2 room apartments, and the balance would be two and one half room apartments. In the construction of this property it is quite different from other buildings of this type.

The first story was strictly fireproof and the other three

stories brick and frame construction, brick walls around each individual apartment, and also dividing the apartment from the stairway. The probable life of the building, taking in these income tax reports, was thirty three and one-third years. That was found in all those reports. Three percent of depreciation on the cost price was allowed in these reports. There was never any objection to using 3%; therefore we assumed they had allowed that percentage. They accepted the tax shown by our report on that basis.

The Claridge Apartments Company acquired the building in August 1st, 1935, that is the petitioner in this case. There was some furniture also acquired. The petitioner acquired the real estate from the Claridge Building Corporation.

I have been in the real estate business over 20 years. I have had quite a varying experience, building buildings, buying and selling property, managing properties, raising mortgages. I have sold property during this time as owner and broker. I managed the building in question in this case from the time it was built up until about 1932, and then again after it was reorganized in the Federal Court—I am still acting as manager. I first began to act as manager immediately after it was built in 1924. During the period of my management, I had occasion to inspect the building. I inspected it sometime every day. Sometimes once a week, sometimes, once in two weeks. During this period, I went in there to take care of all repairs. During the time of receivership under foreclosure, October 1931 to August 1, 1935, I had occasion to inspect the building.

I am acquainted with the fair cash value of the building on the lot on August 1, 1935.

Q. What was the fair cash value of the building at that time?

Mr. Altman: I object to that your Honor on the ground this man has not been qualified to express any opinion with regard to this particular property at this particular date. He said he has been in the general real estate business and he knows this particular physical structure. That leaves quite a gap between what has been done and what in my opinion should be done to qualify this man to give any opinion as to the fair cash value on a specific date. I object on the ground he has not been properly qualified, if he can be.

"The Court: I will take it for what it is worth. It may not have any probative value. Keeping in mind the failure of more specific qualifications, I will take it for what it is worth. The objection is overruled."

Mr. Henry: Most of my time over this period has been building buildings of this character and this size; generally quite large properties, an eighteen story building, fire proof building. I kept some that I built for myself, if I built for a corporation, they kept them, some were sold and some were traded. I started in the real estate business in 1916. I operated all over Chicago as broker. I sold during that time I was selling as broker in Chicago, probably one hundred buildings. I operated, perhaps more on the north side than other sections of the city. The building in question is located on the north side at 4501 Malden Street. The office of the real estate firm where I first began acting as brokerage salesman was right in that neighborhood was about four or five blocks from that property. In 1916 I was doing more brokerage business. I sold buildings at that time. I continued selling practically all the time, from 1935 on, I have just continued. I consider myself fairly acquainted with real estate values in that neighborhood. I can give you the fair market value of this building at 4501 Malden Street on August 1, 1935.

I have different ways of appraising this property, or any other property. In Cook County we value property according to replacement value. On replacement value I cubed this property on that date.

I cubed this building and I estimate there as 81,345 cubic feet. And this particular building in the way it is constructed, having eight front stairs, several corridors, eleven rear stairs, first story fire-proof, one kitchen and bathroom for an average of each two and three-fourths rooms, the refrigerating system, that refrigerating system was put in the property in 1930, we had refrigerators in the property, but we had not included original cost.

I am giving you the value on August 1, 1935. There was either a rollaway bed or inadoor bed for each apartment. There was a refrigerator and gas range for each apartment. Each apartment had a tall china case reaching from the floor to the ceiling. Each bath room had a linen case reaching from the floor to ceiling. Each apartment had two china cases in the dinettes, about five feet high. Each apartment had a full sized mirror in the door.

Each bath room had a vitreous china lavatory and pedestal, and had the best plumbing fixtures of the Chicago Faucet Company, self-losing cocks. There are two large portable Kewanee boilers in this property. One can do the work and is doing the work at the present time.

There are oil burner tank connections and so forth inside of this property. There are six laundries in this property where usually there are two or three in a building of that size. There is an intercommunication telephone system from the office to each apartment which is unusual for a building of this type. There is a large lobby fixed up as a parlor. The size of the lobby is approximately one hundred feet by sixty feet. There is the best terrazzo flooring in this lobby. Then there is a vestibule leading into this property, the size is about twenty by twenty, which also has a terrazzo floor.

Each apartment has a government approved mailbox and push button bells and speaking tubes to the apartments, connecting the apartments to the vestibule.

There is a side walk built on two sides of this property. These eight stair halls and corridors are carpeted. That carpet for stair halls is always included in the cost of the building.

29 This building has a deep court in the front facing Sunnyside. It runs the long way of the lot, which is two hundred feet deep. There are press brick used on the entire outside of this building: Press brick cost forty per thousand. The brick is what we call selected pressed brick, the pressed brick equivalent to being on four sides of this building, on the Sunnyside side, on the Malden Street side, and on the three sides of the court. Usually buildings of this kind, if they have a court, it is in the rear where they can use the ordinary common brick.

Each living room has a bay which consists of three windows. These bays are rather expensive to construct because you must use a certain curve of brick running according to that curve, and inside of this is the same way, the floor, the baseboard and the plaster and the lathing all has to be curved. Apartment buildings of this type usually have one to two windows, one large window, two small windows, and if two windows together they are in one frame. These windows each are in a separate frame. It will cost three times as much as windows in the ordinary apartments, in a building similar to this or this type of building,

I would say. Each window must have a separate shade, two separate rods and holders and separate stops. The stops in this building were put in with screws. In most of the buildings of this type they are usually nailed in with ordinary nails.

The electrical fixtures, all side brackets, usually four side brackets to each living room. Buildings of this character usually have one ceiling fixture.

The flooring in this building is the best grade of clear oak that can be purchased, that could be purchased. The window weights were hung with galvanized rustproof chain. Most buildings use ropes which cost perhaps not half as much. Also takes longer to hang with a chain.

In many of the dinettes the best grade of battleship linoleum was used with metal protection strip between the dinette and the living room and in the dinette between the two cabinets, the linoleum also used in the kitchens. There are a couple of apartments where a carpet was put in at the time the building was built as the people required that that wanted to rent the apartment.

There was considerable landscaping done on this property. It has considerable lawns and courts and so on.

What I have given you is what it would cost to build a building in 1935, less depreciation. I am allowing 3 percent depreciation. Forty-five cents a cubic foot on the cubage which I gave makes \$366,055.20 which the building would cost to build new in 1935.

"Q. August 1st?

"A. August 1, 1935, yes."

I allowed 30 percent depreciation from the time it was built. When it was built it cost \$424,000. I allowed three percent, a year.

If it is for a new building, taking off for a used building. I took off thirty percent, would leave net cost for use of the property, the use of the property to 1935, or replacement cost August 1, 1935, taking off for the usage, or condition of the property as it was August 1, 1935, would make a net cost of the property August, 1935, as used, as it was at that time, \$256,238.64. That is replacement cost. That is one valuation.

The court recessed until 2:00 o'clock of the same day.

When I made this appraisal I used another basis than replacement cost less depreciation. I used a selling basis — what the property would sell for.

Real estate men in selling a piece of property to a prospective purchaser often figure certain factors they use times the rental, the gross rental of the building. On this property here in 1935 I believe the figure was \$43,000 plus, and properties of that kind they sell for six and seven times the rental. That includes the lot. Seven times the rental would be \$301,000.

It was very hard to put any value on the lot at that time because if the lot was vacant the property would not have sold for \$10,000, maybe only \$5,000. I have put a value on the lot of \$15,000 which would be a big price for it. That would make the net value from August 1, 1935, on the building as \$286,000 net, that is with the value of the lot deducted.

Another way some real estate men value properties was so much per room. Of course that is a very difficult way because rooms vary in size, quality of workmanship, materials in those rooms, and the fixtures, where they are constructed and so on. I appraised this building on 31 that basis also. My appraisal there for the property in 1935 as it was, without the lot, was \$347,340. There was something over \$230,000 put in the petition as to value. I had forgotten to add the general contractor's profit in that at that time I think I allowed more than a liberal value on the lot at \$20,000. I don't believe there could be any such value placed upon the lot at that time, because it would be impossible, as I said, to have anywhere near that figure and nobody would build on it in 1935.

The corrected valuation considering the contractor's profit would be \$247,240.

After November, 1937 I looked after the management and maintenance and repairs, of the building. After that date I was president and treasurer, of the petitioner, you were Secretary.

The Clagidge Apartments Company has a record of the amount paid for painting and decorating during the year 1936. We have all the daily records of the decorators. There is a ledger account book. The auditor has those records. I do not know where that ledger is now. I don't know anything about it. You are asking now for the ledger of those accounts for 1936 and 1937. I don't know about 1936, whether a ledger account was kept or not. The management of which I was president and treasurer obtained possession of the books of the company and the

property in 1937. - I don't remember receiving a ledger book then.

I have searched the Claridge Apartments, the premises there, my office, and I asked you if you knew where it was, and asked you to make a search for it, and asked the auditor if he had it, also asked you if you would see the Securities Service Company that was supposed to have kept books to see if they had it. I understand you said you couldn't find it. I have been unable to find it. I have made an attempt to ascertain the correctness or incorrectness of the claim in the 1937 income tax return, that is, the claim for painting and decorating bills, \$4,789.41, and repair bills \$1,819.37. I found it in actual bills, and I gave those to you. I know whether the item of \$4,789.41 put in the tax return for 1937 for painting was a correct figure. It is the correct figure. The figure of \$1,819.37 put in for repair bills in income tax return for 1937 is correct.

32 Cost Book of the Property, marked PLAINTIFF'S EXHIBIT NO. 3 for identification offered in evidence.

Mr. Altman requested the privilege of cross examination before Plaintiff's Exhibit No. 2 received in evidence.

Cross-Examination by Mr. Altman.

I purchased this book on behalf of the Claridge Building Corporation, that is the old company, the predecessor of the taxpayer. At the time I purchased the book, we did not have a bookkeeper. The corporation was just organized, just incorporated at that time, so I bought the books, kept the books. No, I had a bookkeeper at that time. The bookkeeper checked the items in the book.

We checked back when the checks were returned from the bank. He would take each check and see that that check had been properly entered. He would check every one that came in. He did not make any entries in this book, except there are a few figures he made. The pencil notation here is his figure. It is a footing. I think the entries were all made by me alone. Here is an item that was made by him. It was interest on some money borrowed for this building by the corporation. These two items here are made by the bookkeeper. They are for Morgan Sash and Door on account, \$3,500, May 1st; June 5th, Morgan Sash and Door, on account, \$6,500. There

is a notation of items entered down here. Those are made by the bookkeeper.

I did not let the bookkeeper make all the entries in that book because when a contractor would come in for money he would bring in a waiver of lien and his work would have to be checked to see what he had done. Sometimes a contract in many instances they would ask for more money than they were entitled to. It took a man of experience and knowledge to know how much work had been done and what the value of that work was. This bookkeeper, I don't think any bookkeeper is able to do that, so I would do that. I would check over the waiver and at the same time we would agree how much money he was entitled to and I would draw the check and give it to him. Instead of calling the bookkeeper to make the entry, while I was doing it, I would make the entry myself. I would draw the check to the contractor who came in. One contractor got one check at a time.

Q. Didn't you get part of the checks under this custom this building was operated under? In other words, didn't you have an arrangement with these different contractors whereby they contracted for one price but actually got a lesser amount and you got the difference because of the fact you were in control of the job? Isn't that a fact?

A. No, sir, it is not a fact. In other words, if I grafted on this property?

Q. I didn't say graft.

A. Well, it is the same thing. Furthermore, you can check each and every one of those contracts to see if they received the amount of money shown in that book. I will be glad to have you do that to your own satisfaction.

As to whether this book contained amounts paid after the completion of the building—completion of the construction of the building. If you call it completion of the property, no. Those items were all during completion. In other words, the brick work might have been up, the ceiling might have been on, might have put some additional work in one of the apartments. I would consider that all part of the construction of the building, a part of the cost of the building. As soon as the work on that particular job was finished and one contractor brought in the waiver he was given his check.

I started this building—the first payment was made, as

you will see, on Page 1, in February. I believe that was for the plans. When you draw the plans you can say we started the building. The actual building was not started until we began to excavate. Some say you start the building when you draw the plans because that is part of the cost of a building. We began excavating in the spring of 1924. We completed the building in 1924, approximately in the fall. Some apartments were ready for occupancy there in September. The date of the last payment made on this building was on January 28, 1925. It is \$3,800 to C. J. McGurn, in full. That was for plastering and lathing.

I do not know whether the landscaping is included, without looking at the book, because the landscaping might have been done in the spring of 1925, the year after the building was started. If it was at that time, it might have been put in with some expenses instead of cost. It looks as though that is the way it was done. I don't see it in the cost of the building where it should be put.

We have an alphabetical list in the beginning. Landscaping would be listed under "L". It should be put in and added to the cost of the building that I have put in there. So I shall have to figure out to see what that is and add that to the cost of the building.

34 Since the entries were made in the book in 1924 and 1925, as I testified before, it has been up there in storage at the Claridge. It was in the storage room there. It had been kept in the storage room. I don't believe Mrs. Case has ever seen the book. At least I don't know whether she would know what it was.

It was kept in a storage room with other papers and things. A lot of things were kept in storage. I looked quite a while before I found it, in fact, I thought it was lost. Mr. Hamilton asked me for the book and I looked for it and I made another search, and this is the first time I have seen this book from the time this book was purchased and those entries were made in it at the time the building was built.

The book wasn't turned over to the new officers and directors that got into the corporation after I got out.

I don't think I have any of the vouchers or cancelled checks which would substantiate the entries in this book. I think they probably are all thrown out by this time.

I did not make the footings which add up to the figure at the end of page 11, the bookkeeper totaled them.

I was general contractor for the Claridge Building Company for the construction of this building. All expenses in

curring as contractor in constructing the building are entered in this book. It is not my personal book. I was keeping this book for the corporation. This book was a corporation book. It is all one book, not two sets of books. I had no books to keep for myself personally. Everything I did, I did for the corporation. It don't take any book to put down ten percent profit. This is the set of books we had right here for the cost of construction of that building. We kept no book other than that. I kept a record book as general contractor. That is the book I have in my hand. It is marked for identification Petitioner's Exhibit No. 2.

I was an officer of Claridge Building Company in 1924. I was president or secretary, I am not sure, one or the other. I did not own all of the stock. I just don't recall how much I owned. That was 16 year ago, or seventeen years ago. I haven't checked back there exactly how much stock I had. I am not sure how much was issued. I held a majority of the stock. I am not positive how many I held. I haven't seen any records since seventeen years. I haven't even thought about it. This is the first time the question has been asked me.

The corporation hired me as general contractor, the officers and directors of the corporation.

"Mr. Hamilton: I think that is going far afield to identify a book.

"The Court: I think so myself.

"Mr. Hamilton: I will object to any further cross-examination.

"The Court: I don't see any reason why this witness can't answer the question.

"Mr. Hamilton: He can answer what his knowledge is.

"Mr. Altman: I think it will become apparent increasingly as we go along what is behind this.

"Mr. Hamilton: There is nothing behind it.

"A. (By the Witness.) To the best of my knowledge I and my brother, Howard Henry, and I think Mrs. Case. I think we were."

Mrs. Case is my sister. I think we were. I will have to check to make sure. I am just giving my best recollection that we were officers of that corporation.

It is not a fact that I controlled the corporation. Any two directors were controlling.

Mr. Altman: I will object to the introduction of that book in evidence on the ground it is not the official record.

not been shown to have been the official record of the corporation, and there is nothing in the book to indicate to whom it belonged. It is without a caption, without an address or anything else that would show it related even to the building we are talking about. The word "Claridge" is penciled on the front, so I am not satisfied this was not the personal book of this witness rather than of the corporation and for that reason I think it is incompetent as evidence. Furthermore, it is not the best evidence of the disbursements made therein.

Mr. Hamilton: His own handwriting, and kept at the time of the entry and kept all these years. If that is not the best evidence, I don't know what evidence is.

36 The Court: Tell me what difference does it make.

Mr. Altman, whether this book was kept by the corporation or by this individual if it shows the actual expenses paid for the building. Mr. Hamilton may have to connect it up by showing the corporation by Mr. Henry paid what was paid out of this book, but if it can be connected up to that extent certainly this will be the best possible evidence of what the building cost.

Mr. Altman: Certainly that tie-up has not been made. I object on the ground it is not material or relevant until that tie-up has been made.

Mr. Hamilton: I think I have already made the tie up. I asked who made out the checks for the corporation, paid the checks to the various workmen.

"Q. (By Mr. Hamilton.) What is the fact about that?

"A. The corporation paid out the money, yes, sir."

Mr. Hamilton: Certainly a \$340,000 loan the company would not allow anybody else to pay out except them.

Mr. Henry: I signed these checks, for the corporation by me; Claridge Building Company by Charles F. Henry. They authorized me to sign them.

"Q. Who authorized you?

"A. The other directors and S. W. Straus who made the \$340,000 loan had to approve all these payments and checks also before they went through for payment. That is something that would not appear in any way at all on this book.

"Q. The question is whether you are prepared to testify that the payments that are set forth in here were payments made by you on behalf of the corporation with the authorization and approval of the corporation's officers and directors, which I understood you to say a few minutes ago was not yours, that you did not control the corporation?

"A. That is right.

"Q. I understand you to say then these payments that are recorded in here were actually made by you out of corporation funds and on behalf of the corporation by the corporation's checks which you signed as one of its officers?

"A. Yes.

"Q. That applies to every expense that is set forth in this book, is that correct?

"A. Yes, sir. A few of those entries were made by the bookkeeper. The most were made by me.

"Q. I am not asking you at the moment who made the entries. I am asking particularly with respect to all the figures that are included, whether what you have just said applies to all of them?

"A. Yes, sir, it does.

37 "The Court: Objection overruled. It will be received in evidence.

"Mr. Altman: Exception, your Honor."

Said book was received in evidence and is so bulky by stipulation the original of it will be sent to the Circuit Court of Appeals, in lieu of a copy thereof.

Direct Examination (Resumed).

Tenants went into the building before the entire building was completed. The first apartments were occupied October 1, 1925.

I employed union labor on the building. The cost of union labor in 1924 and on August 1, 1925 was about the same. There was some difference between the cost of materials used in this building in 1924 from the cost of materials that would have to be used to replace it on August 1, 1925. Some of them were lower in 1925. Brick were lower and lumber was lower, about 10% lower for lumber. The millwork was about the same.

Reorganization plan, was marked PETITIONER'S EXHIBIT 3, and was offered and received in evidence, and is attached hereto as exhibit.

"Q. (By Mr. Hamilton.) I show you this document marked Petitioner's Exhibit 3 and ask you to examine that. Do you know what that is?"

"It is a plan of reorganization of the Claridge Building Corporation, it is a plan that was adopted except as modified by the decree of court in this reorganization in question in this case.

It is stipulated in the record that non-depositing bond holders received proper notice of this plan before it was adopted by this Court.

Notice of Adoption and Filing of Plan of Reorganization, dated December 14, 1934, was marked Petitioner's Exhibit 4 for identification.

I know that this Petitioner's Exhibit 4 for identification, being Notice of Claridge Apartments Bondholders Committee's Plan to their depositing stockholders was sent out to depositing stockholders about the date it bears, prior to its admission to the Court.

PETITIONER'S EXHIBIT 4 offered and received in evidence, and copy of same is hereto attached.

It is stipulated that the Claridge Building Corporation bond holders committee were vested with full power under the deposit agreement as if they were absolute holders of the bonds, and had the right to negotiate and perfect this reorganization agreement.

38. Document marked Plaintiff's Exhibit 5 for Identification dated May 14, 1933, purporting to be an order of Court approving plan of reorganization and allowing certain claims, which was identified by the witness, and he testified that it was actually entered by the Court while he was president. The same was offered and received in evidence as PETITIONER'S EXHIBIT NO. 5, and copy of it is attached hereto.

Petitioner's Exhibit No. 6 for identification, being an Order signed July 22, 1935 in the 77-B proceeding which involved building corporation, was offered and received in evidence as PETITIONER'S EXHIBIT NO. 6 and attached hereto.

Mr. Altman: I move to strike out exhibit just admitted on the ground it is not a complete copy inasmuch as the documents referred to in the instruments have not been offered in evidence and the document is unintelligible without the exhibits.

The Court: It seems to be a complete order. Motion denied.

Document marked PETITIONER'S EXHIBIT 7 for identification, being copy of Petition that was filed in 77-B proceedings in this Claridge Building Corporation case, was identified by the Witness. It was offered in evidence and is attached hereto.

PETITIONER'S EXHIBIT 8 for identification, being an

order entered in the 77-B proceedings of the Claridge Building Corporation was identified by the witness.

It is an order authorizing the new corporation to borrow \$18,500 with which to pay back taxes due and if necessary, some of the reorganization expense.

It was offered and received in evidence without objections, and is attached hereto.

Petitioner's Exhibit 9 for identification, being a verified report by the Bondholders Protective Committee and Minnie H. Case and Claridge Building Corporation, showing they had carried out all the things required to be done by the decree of the court, approving the plan, was identified by the Witness, was offered and received in evidence as **PETITIONER'S EXHIBIT NO. 9.**

The Petitioner offered in evidence **PETITIONER'S EXHIBIT 10**, being an order of Court in case No. 56230 in the matter of Claridge Building Corporation, which was entered as part of that case August 13, 1935 by Judge Sullivan in the District Court of the United States, Northern District of Illinois, Eastern Division, in which that Court entered a finding that the bondholders protective committee and Minnie H. Case and Claridge Building Corporation have done and performed all the things and acts required to be done and performed and executed and delivered by them in the execution and confirmation of the plan of reorganization as amended and decrees and orders entered herein. It was received in evidence, and attached hereto.

PLAINTIFF'S EXHIBIT 11, being a Trust agreement of Claridge Apartments Company, dated July 1, 1935, the trustees being George W. Rossetter, Jay Mc Cord and Paul Steinbrecher, the agreement resulting from the reorganization in the case of Claridge Building Corporation involved in this case and approved by the Court under one of the orders offered in evidence in this case and approved by the Court, and one of the orders under which they acted in this reorganization. It was received in evidence without any objection. The document is bulky and original will be certified to the Circuit Court of Appeals.

39 Carbon copy of letter dated February 14, 1942, signed by Walter Hamilton, which purports to give the list of stockholders to whom stock was issued, giving all the names of the bondholders who received stock direct and also the three trustees who received stock direct, and the equity holders of the old corporation receiving stock direct.

The same was admitted in evidence subject to checking against the books, as PETITIONER'S EXHIBIT 12.

Mr. Hamilton: I examined the records in Cook County in the Court House here in Chicago and I found on the 14th of April, 1932, the Claridge Building Corporation made a conveyance of the property involved in this case, 4501 Malden Street, to Minnie H. Case. It is stipulated that such conveyance is on file.

Mr. Henry: I know about this deal between the Claridge Corporation and Minnie H. Case. When the Trustee, Melvin L. Straus, was operating the Claridge Apartment Building Mrs. Case's attorney advised her, and he also advised the officers of the Claridge Building Corporation to let Mrs. Case hold title to this property. He thought he could effect—it would be better for the reorganization of the property later on. I know that Mrs. Case paid nothing whatsoever for the property. The understanding was she was to hold title for them until they ask to have it deeded back or to whoever they wanted to deed it to.

Examination by Mr. Altman.

Mr. Henry: The understanding between Mrs. Case and the Corporation was an oral understanding.

Concluding Examination by Mr. Hamilton.

Mr. Henry: I am familiar with all these documents which we have introduced in evidence here. I know whether or not all the documents therein contained are true or not as to the facts they set forth and whether or not all the orders mentioned in there were carried out or not in this reorganization. They were all true and they were all carried out.

The time Claridge Building Corporation made this transfer, it was insolvent. It did not do business after this transfer.

The other bond holders who did not get stock, obtained trust certificates under this reorganization. They got one trust certificate for each \$100. bond, par value.

Minnie H. Case owned 98 shares of the Claridge Building Corporation before this reorganization. There were 100 issued altogether. Mrs. Case got title to these 98 shares because I owed her some money, so I gave her the

stock for the money. That was before the reorganization. There was no written agreement in regard to it.

The Claridge Building Corporation owned just prior to the transfer on August 1, 1935, the lot at 4501 Malden Street. I was president of the Claridge Building Corporation when it was organized. I don't know exactly how long I remained president. I would say probably six or seven years. I kept in touch with this property up to the first of August, 1935. I know what property it owned on August 1, 1935. It was the Claridge Building and the ground at 4501 Malden Street. It owned also part of the furniture that was put in there by the Trustee and paid out of the rents.

That was all the property it owned at that time out side of what cash it had on hand. This was all the property that was transferred to the Claridge Apartment Company. They got nothing else.

The following are the names and the number of buildings I have built as a builder in Chicago:

Thirty-Seven apartments, 3, 4, and 5 rooms on Cornelia Ave., near Brompton Place, on the North Side.

Ninety-Six fireproof apartments at the corner of Marshfield and Cornelia Avenue, on the North Side.

Eighty-Seven apartments, one to five rooms, at the north west corner of Wilson and Winchester Avenues, on the North Side.

One Hundred and Fifty-One apartments, fireproof, eighteen story building, 201 East Delaware Place, on the north side.

Twenty-four apartments at 70th and Merrill Avenue, four and five rooms, on the south side.

One Hundred Eighteen apartments at Drexel near 44th Street, on the South side.

Forty-six apartments on the southwest corner of Drexel and 44th on the South side.

Sixteen apartments at the corner of Addison and Jansean, on the North Side.

41 Twenty-seven apartments at 630-28 Gary Place and four apartments on Rokeby Street near Waveland, on the North side.

Forty-two apartments on Cambridge and Diversey.

One Hundred and Six apartments, 4501 Malden Street, the building in question.

*Statement of Evidence.**Cross-Examination by Mr. Altman.*

I originally owned the lot at which the building at 4501 Malden Street was erected. I bought part of it for cash and part for trade. I sold it to the Claridge Building Corporation, for \$100,000, which included my ten percent profit of \$38,500. The deal wherewith the land was conveyed was \$38,500, 10% commission, and \$61,500 making a total of \$100,000. I owned all the stock except one or two qualifying shares. I told that stock up until 1932. I think I held it from 1924 to 1932, somewhere along that year. I am not sure as to the dates. I had it for several years. I held it.

I sold it to Mrs. Case. She paid me cash for it. I owed her the equivalent of \$98,000. She didn't owe me, I owed her.

Mrs. Case did not live in the building before that. I don't know of anything she got payments from the corporation for. She did not manage it from 1924 to 1933. I looked after it at that time. I did not pay her for management of it during that period. I managed it.

In the reorganization plan, they allowed her to manage it and paid her a fee. It was what the bondholders' committee and so on agreed to do, and the lawyers of the corporation. I don't know what their ideas were. They all got together and agreed to let her manage the property and paid her a fee. That was at the time of the reorganization in 1935. Before that she also helped me with it. She always did as long as I have been in business.

Prior to 1934, the Claridge Building Corporation did not pay Mrs. Case anything for services. As to whether she rendered any management services, she assisted once in a while, helped a little. She had some furniture in the place. She received rent for the furniture from the Claridge Building Corporation. They did not pay her a salary. They paid her for the furniture she put in there.

42 She had a contract with the Trustee, the bondholders' committee. I think that was in 1931. I helped her negotiate the contract. I did not suggest that the property be conveyed to Mrs. Case and that she hold title to the property. I think I was an officer of the Claridge Building Corporation in 1931. I think I was still President.

I was an officer of the Claridge Apartments Company that was organized in August 1935 before it was dissolved. I thought you were talking about the Claridge Building Corporation. I think I was an officer of the Claridge

Apartments Company. In 1937, I was President I believe for four years. The minute book shows I was president. This is November 15, 1937 the meeting was held, and at that time I signed here as Director, also president; Walter Hamilton, secretary, Charles F. Henry, Treasurer. I am Charles F. Henry.

I am an officer of the petitioner Corporation today. I think I am president and Treasurer of it now. I am quite sure. My final figure of the market value of this property on August 1, 1935, is \$256,238.64. That is the fair market value of the building without the land on August 1, 1935. The real estate conditions in Chicago in that particular neighborhood where this building is located was poor, there was no building going on. The market for the purchase and sale of this property wasn't very good. It was a very poor market. It was not one of the worst markets we have known in the history of Chicago. 1931 and 1932 were much worse. Buildings were sold in 1935, in fact a fair market for buildings in 1935. Things started getting better in 1933. 1936 was better than 1935. 1937 wasn't much better than 1936 as to real estate. Renting wasn't any better in 1936 or 1937. In other words, in this building here the rents in 1935, 1936, and 1937 I would say were the same.

1937 may have been a little better market for selling than 1936. 1937 showed a definite up turn more for securities and stocks and so on than it did for real estate. You probably couldn't get much more for the building in 1937, but there were probably more buyers I would say. To sell a property of this kind and size is always hard, whether it is a good market, as it is too large. Most people don't want a building of this size.

43 In 1938 and 1939 things did not continue to improve as to real estate. They did not improve for this type of property. I understand we meant by the fair market value of property, the replacement value of this property or what it should sell for for what is there. What it should sell for, yes, the property should sell for; what it would cost to replace it. I mean what it should sell for if I sold it. You have to almost give a piece of property away in order to sell it. It may be worth four times, that sometimes happens, if it was a sale of property under the hammer, if not many buyers for a piece of real estate. To sell a particularly large piece you would have to sell the building at half of what it is actually worth. What a

piece of property sells for is of no significance of the actual value of the property. What a property would and could be sold for depends on the market at that time. I gave one appraisal on the rental basis. Property sold in 1935 six or seven times the rental of the building, on the ground, unfurnished, actually sold for that; for cash, that is cash and the balance between that and the first mortgage. These figures I have given you, about two hundred and fifty-five thousand or sixty thousand, are what the property should sell for. I might sell for that much money, might have sold for that much money in 1935. In my opinion the property would sell, if I had to sell it on August 1, 1925, for that figure I gave you, \$256,000. It would have sold for more if the property had been handled by a real estate man, to some buyer. I think a customer could have been found to buy the building at that price, on August 1, 1935.

In the case of this particular apartment what it should sell for and what it could sell for was the same thing in my opinion. As to the value of real estate during the year 1940 as compared with the year 1935, it wasn't much better. The rents for this kind of property were the same. The selling market in 1940 might have been a shade better; not very much. That is my opinion as an expert on this type of property. Only a shade better than 1935 for this type of property.

For residences in the suburbs, it was much better. This property was only a shade better in 1940 than it was in 1935.

44 The Claridge Apartments Company does not own this property now. They sold it in 1940, July 1st, the government knows it has been sold. The income tax has been filed, made out for this property and paid by somebody else, made out by somebody else.

I was president of the Claridge Apartments Company in July, 1940. It was sold to the Claridge Corporation. I am not an officer of the Claridge Corporation. I was not an officer of the Claridge Corporation at the time of the sale. It was another corporation entirely, nothing to do with this other association, Claridge Apartments Company. The stockholders of Claridge Apartments Company negotiated for the purchase of this property and they, the corporation notified all these stockholders and talked to them, told them they thought that would be a good offer for the property, give them a chance to get out, and so

they accepted the offer. The offer was, as near as I can figure, \$126,200. I believe that was the figure arrived at. That included land, not the furniture. The new company did buy the furniture. That is the Claridge Apartments Company bought the furniture for \$1,400. This \$126,200 included everything, the land, building, and the furniture. There was some litigation instituted to prevent the sale of the building for a smaller amount. There was a lower offer submitted to the old bondholders' committee, Straus, that made the loan, the Straus Securities, and the trustee, Melvin L. Straus, they all thought it should bring more money, and they thought the bondholders should sell, so they recommended the deal, there was a higher offer made, and they recommended this deal to the bondholders, that the bondholders should take it and get out of it. I couldn't sell the property without the consent of sixty-six and two-thirds per cent of the stockholders. There was an offer submitted to the stockholders, some were prepared to go ahead and some were not. There was litigation. I was away at the time the sale was taking place. I wasn't in the city at all. I think I was in California, if I remember right. The lawyers negotiated back and forth. There was a little misunderstanding, I believe, between the lawyers and so on, and there was some misunderstanding. Some lawyer bought a bond in order to make an attorney's fee for himself. He started some sort of a proceeding. As soon as he arranged to get his fee, he withdrew. I don't think I was sued personally. I think probably the corporation was sued. I couldn't individually do anything.

Q. What did you pay for the stock of petitioner corporation when you bought it in 1937 and 1938?

Mr. Hamilton: I object to that, your Honor. That has nothing to do with the value of the property.

The Court: Objection overruled.

The Witness: I didn't buy the stock in 1937 and 1938.

I had no arrangement for the purchase of it by somebody else in 1937 and 1938. I always had stock. You are talking about Claridge Apartments Company, are you not? I always held stock, given stock by the government in the reorganization. I was given eight shares.

As time went on, I bought more stock. I presume I bought some in 1937. I don't think I bought any in 1938. I don't know how many shares I bought in 1937, or how

much I paid per share, I don't remember. I haven't any idea at all.

This stock was offered by brokers different times. When something was offered I could buy for my own price, I would take it. I did not buy enough shares to have control in 1937. I was buying since it was reorganized in 1935. I paid all the prices I could get for it. I think the most I paid was between \$25, \$27 and \$30 per share. There were 3,078 shares outstanding. I was paying around \$25 to \$30. I paid more than that, I paid as high as \$35.00.

I bought some of these certificates of deposit before the new company was formed in 1935. My sister did not buy any that I know of.

RESPONDENT'S EXHIBITS "A", "B", "C", and "D" being Federal Income Tax returns of Petitioner for the years 1935, 1936, 1937 and 1938 inclusive, were marked, offered, and received in evidence.

The record shows there was \$8,000 on hand in the old company when the reorganization took place. The petition shows that they raised \$18,500 by a loan. The two together made \$26,500. With this money, they paid back taxes and attorneys fees and bondholders committee fees and so on. They paid fees to the bondholder's attorneys. If it shows that Osborne got fees, that is correct. Yes, the whole \$26,500 was spent for the bondholders. For the reorganization plan and taxes and Osborne, Klein & McCurren and so on. Part of it went to the attorneys who formerly worked out the plan. The Trustees paid the bondholders. All the money was spent for the bondholders. The bondholders paid this money back to the firm that loaned it.

As to whether the \$26,500 was turned over, was paid, by the new company by its own checks, I am trying to see if they did it or the attorneys did it after the reorganization. I am not sure what was done. I don't remember who signed the checks, but according to these figures, if you want to shorten this, these figures are correct and besides the names of the attorneys and so on are listed who had received this money.

The new company was not to pay all these reorganization expenses. All these items on the sheet here says are to be paid by the Claridge Building Corporation. It says the Claridge Building Corporation right there. They are to be paid by the Claridge Building Corporation, \$2,000

attorneys, and so on. All attorneys to be paid by the company, right in this file. It is a statement of unpaid fees and expenses September 20, 1935, to be paid by Claridge Building Corporation. The Claridge Building Corporation was in existence at that time. The Claridge Building Corporation was still in existence at that time, yes. They had paid their franchise tax, and were in good standing at that time.

There were a few bonds in Claridge Building Corporation that were not turned in. They were not turned in to the bondholder's committee. I think there were a few probably could not be found. I presume a few were not turned in. I don't know if they were cancelled. I never cancelled them. I never did cancel them. Whether the attorneys had power to cancel them or not, I didn't handle that part of it. If the plan says you ask if I knew they were cancelled, I don't know if they were cancelled.

I testified the value of the land in 1935 was \$15,000.

I did make an appraisal of the land at \$20,000 with the government. I said I thought I had valued it at five thousand too high, and it is only worth fifteen.

It is my understanding that all provisions in the Court decree in regard to carrying out the plan were actually carried out.

47 *Redirect Examination by Mr. Hamilton.*

The selling price for the Claridge Apartments Company was \$126,200. There were liabilities assumed by the purchaser in that deal. I think they were around fifteen or twenty thousand, something like that. We figured about twenty thousand. There were these taxes the government claims, we had this lawsuit, that was assumed by the purchaser, and there were a lot of back real estate taxes assumed by the purchasers, unpaid bills, salaries and so forth were assumed by the purchaser. It might have been more than twenty thousand. That ran into a lot of money.

As to the \$26,500 I do not know how it was spent. The taxes were paid. Everything was paid out of that money. Now, I think there is enough money on hand to pay the taxes with. There were \$13,000 for taxes and \$8,000 on hand. The reorganization was \$13,500.

It seems to me there was a mistake in the figure of the

stock, one hundred shares, \$100 a share, in the reorganization of the Claridge Building Corporation. It would be only \$10,000. The original capitalization of the Claridge Building Corporation was \$100,000 eventually reduced to \$20,000.

Recross Examination by Mr. Altman.

There was not \$15,000 cash on hand obtained by the Claridge Corporation from the Claridge Apartments Company in this deal. Refreshing my mind, from this document, there was not that much money on hand from the Claridge Apartment Company. What I am trying to say is if there was that much money in the bank it didn't belong to the Claridge Company. In other words, it was put in there to bring up that amount so the deal could be made. They took over all liabilities and the cash on hand. Whatever it gives here, these figures are naturally correct. The correct figure is \$126,000, for the value of the property, as I gave you before. Here are the liabilities. Instead of the Twenty Thousand figure which I gave, it shows \$22,145.36. The cash on hand was \$15,000. They estimate there would be \$3,200 in rent coming in January 1, 1940, to March 31, 1940. If the new company, The Claridge Corporation, collected it, they delivered it to them, yes. There is also a \$3,000 item which the purchaser was to pay to attorneys of the bondholders and to Sonnenschein, Berkson, Lutzmann, Levinson & Morse, attorneys for the plaintiff. It was in addition to the amount paid for the property, it shows right here.

The building was partly fireproof. The first story is fireproof. The rest of it is what is called semi fireproof. The floors above the first floor are what we call wood construction. In fact, we have semi fireproof insulation, the walls all fireproof in each apartment and stair hall walls are also fireproof. I would call the second and third floors semi fireproof.

Petitioner rests.

MILTON J. ISAACS, a witness, called on behalf of the Respondent, testified as follows:

Direct Examination.

My name is Milton J. Isaacs. My business address is 135 South La Salle Street. I am employed by Straus Securities Company. I am appearing in response to a subpoena served upon the Straus Securities Company. During the 1935, I was employed by the Straus Securities Company as a manager of the Trading Department. My duties consisted of buying and selling securities over the counter market. All these securities that were bought and sold, were bought and sold on behalf of Straus Securities Company. These securities included certificates of deposit of defaulted bonds of real estate company in 77-B proceedings. Also stock of real estate companies.

Prior to August 1, 1935, we purchased and sold securities of Claridge Apartment Company—we purchased on behalf of Straus Securities Company certificates of deposit of bondholders who had deposited bonds issued by the Claridge Building Company which was in 77 B reorganization proceedings at that time. Each certificate of deposit covered one bond of a thousand dollar denomination, yes.

Q. At what price did you purchase such certificates of deposit in 1935?

Mr. Hamilton: I want to make objection to this testimony. I can't see any materiality to this at all.

The Court: Objection overruled.

Mr. Hamilton: (Continuing.) What the stock sold for. Exception.

A. We show in January, 1935, certificates of deposit for this company were purchased at \$20, a hundred or a price of \$200 per thousand dollar certificate, and after that the same securities sold on a range from \$190 per thousand to about \$207.50 per thousand.

Q. That means a thousand dollar bond which the depositor deposited with the protective committee and received a certificate of deposit, we paid that amount.

Our next record shows a transaction in December of 1935, at a price of \$190 per thousand dollar certificate of deposit. The stock to my knowledge had no value whatsoever, and it didn't trade in the over the counter market.

During 1937 I purchased, as agent for Mr. Henry, some of the stock of the new company, the Claridge Apartments Company.

Cross-Examination by Mr. Hamilton.

I do not know what connection the Straus Securities had with Straus that wrote this bond issue for \$340,000. I do not know whether they had a list of bondholders that were sold under that \$340,000 issue. I do not know whether they had people who were soliciting these bondholders to sell their certificates of deposit. I do not handle customers. My duties are buying and selling securities to dealers. Mr. Henry is not a dealer to my knowledge. Straus Securities Company sold to him.

People desiring to sell securities call me as well as they would any number of houses that deal in over the counter securities for a market for these securities. I would not answer whether or not that particular sale was in distress. I can't answer whether or not most of the bondholders who sold their securities at that time were in financial distress and sold the securities. I would not know, not dealing with the individual. I can't answer whether they could have been. Unless I knew the circumstances of the individual. I would not know whether it was in distress or not, but in dealing with the general over the counter securities dealers, I don't think they would be in distress. I don't claim to be an expert to say whether a party is in distress, or he is not in distress. I do not know about that.

Q. Isn't it a fact there were so many of those bonds on the market in Chicago, that there was practically no market at all for them and the prices offered were ridiculous, considering their true value?

A. According to the records of our entries the amount of stock or certificates of deposit traded would not indicate a large supply.

We were one of several houses dealing in those securities.

Q. And the bondholders could not get anything for their bonds commensurate with what they were worth at that time?

A. That is not correct.

Q. You mean to tell me the buildings which were back of these bonds were not worth any more than the percentage that you paid for the bonds?

"A. Not being an expert on valuations, I could not answer that."

"I assume S. W. Straus underwrote this \$340,000 bond issue. I can't answer whether or not the Claridge Building at 4501 N. Malden St., was not worth more than \$20 for a \$100 bond, that is, the property was not worth any more than what for a \$100 bond."

"Q. Do you think it was backed by more or less than \$20? Were the assets which are in that property worth more than \$20 for \$100 worth of bonds, were they worth more or less than \$20?"

"A. I am not at liberty to say. I do not know the values of real estate."

"I am an expert only in the purchase and sale of securities."

"Mr. Altman: Just a minute. I want to make the point, this examination is not proper examination. It does not deal with anything within the scope of the direct examination. I subpoenaed this man to testify to some securities he traded. He is being asked what the building was worth."

"Mr. Hamilton: The only purpose is, he has asked this witness as to the value, what this stock was worth."

"The Court: I believe you are correct about that. I am going to let you go on with the examination. I am going to point out to you as far as this witness is concerned it does not seem as though there is any possibility of getting any answers to your question. I am not sustaining any objection on the ground of materiality, but I hope you are not going any further into that than enough to convince yourself you can't get an answer out of this witness."

"(By the Witness.) The only thing I can say is that the market on those days as is reflected by the purchases and sales were the prices in which we dealt in those securities. As to their value, I am not here to testify whether they were worth twenty cents or worth fifty cents. I do not know about that. There wasn't any exchange on which these bonds were offered. No exchange like a stock exchange where these bonds were offered. They were over the counter securities, sold to individual brokers."

"We would not buy them and sell them on the same basis. I am sure we weren't selling at the same price we bought them. The purchaser was the one that paid this commission to us, not the seller. I am not at liberty to say how much the commission was because I don't know. I do not

know the sale I mentioned of \$20. for the \$100 bond eventually cost the purchaser \$25. I have no idea about that.

Redirect Examination by Mr. Altman.

There were six transactions in 1935.

JOHN C. BOWERS, a witness on behalf of Respondent testified as follows under direct examination:

My name is John C. Bowers. My address is 5000 Marine Drive, Chicago. I have resided there for six years. That is in the general neighborhood of 4501 Malden Street. My place of business is at 4628 Broadway. That is a few blocks from 4501 Malden Street. I am familiar with the property known as the Claridge Building at 4501 Malden Street. I have been within a radius of a block and half of that section for twenty-seven years in business. I am in the real estate business and property management and appraisal of property. I am also a broker. I am a licensed broker, and have been so licensed since I have been in business. At the present time I am treasurer and a member of the executive committee of the National Association of Real Estate Board. During 1935 I was president of the Chicago Real Estate Board.

I have made appraisals for various agencies of the government. I would say practically all of the appraisals that were made for the Home Owners Loan Corporation would bear my signature, as president of the Chicago Real Estate Board. The Chicago Board made these appraisals and it was necessary the president of the Board sign them and pass upon them. I am in business for myself at that address. It is a real estate firm.

I have acted as a broker in a number of transactions and I have purchased or traded in properties myself, dealt in them, during the last ten years in that neighborhood; the general neighborhood of the subject property. I remember when the building at 4501 Malden Street was put up. I lived just a short distance from there, and I had to pass it when it was being built. I would say it was about around February, 1924. I watched the progress of this building during the course of its construction somewhat.

My general knowledge of this building and other build-

ings of the north side, I have made it my business to keep in touch with real estate, the sale of it, the prices owners were asking for properties, the price property sold for.

I think I have a rather thorough knowledge of the sale of real estate. This building has never been listed in our office for sale. I mentioned before I was in the property during the time it was under construction and have made an inspection of it recently. The building is three-story and basement court type apartment building, has entrance or lobby which is large and stairways radiate from the lobby up to the various landings. The floor of the building is terrazzo type floor, terrazzo finish, and six stairways lead up to the sets of apartments, groups of apartments, off this lobby. Each one of those six stairways have twelve apartments and two more stairways have fifteen.

The building, I would consider it to be, well, it would be classified as concrete slab construction, the first floor and ordinary wood joist and plaster construction with brick walls separating the various apartments on the second and third floors, the top floors.

There were some stores in the building. I don't recall just now whether they were in there at the time the building was built or not, but they were in there shortly afterwards, and I think were in the property in 1935, but I believe were in violation of a city ordinance and afterwards were closed.

It was a violation of a building ordinance not allowing stores to be built in that section of Chicago. The terrazzo floor in the lobby has cracked in several places which denotes settling. The same is true in some of the corridors leading up to the stairway cases also. The terrazzo is badly cracked. It shows the lack of proper footings or proper foundations under the floor.

In my experience in this business, I have familiarized myself with the details of construction so that I can tell a building that is poorly constructed from one that is moderately well constructed, and one that is very well constructed. That type of information is necessary to the prosecution of my business. One must have a thorough knowledge of the different types of construction. Based on that knowledge, in my opinion, I would say that the construction of this building is average.

I am familiar with real estate conditions in 1935, and

the market for buying and selling of apartment buildings of this type. I am familiar with the market for apartment buildings in this neighborhood, 4501 Malden Street, also, for the year 1940.

The prices obtainable in 1940 were considerably above those of 1935. The market was much more active in 1940. There were more buyers. It was much easier to - it has been much easier to obtain mortgage financing in 1940 than it was in 1935. As a matter of fact, in 1935 the market was quite dull, inactive. Some residential properties were selling, some small two-apartment and three apartment buildings were selling, and a few other scattered properties, but the market would be considered dull insofar as income from the properties was concerned. It was abnormally dull compared with 1937 and 1940. There was very little similar property sold in that neighborhood in 1935. There was a sale of a parcel of property at 4500 North Malden Street. That is directly across the street from this building. It is a three story building, English basement type, similar to the building under discussion here, on a corner lot, 150 by 150, containing 33 one-room apartments, 24 two room apartments, 15 three room apartments, and 3 four room, and 3 three room apartments in the basement. That was sold in December of 1935. It sold for about \$107,000. That was for the land and building, and furnishings. This building is completely furnished. They were all furnished apartments. I would say this building was similar to the building at 4501 Malden Street. The building at 4500 was a building of a comparable construction. The room sizes are larger here in this building than in the building in question. There is more privacy in this building due to the fact there are separate entranceways leading up to apartments. You don't have to go through a central corridor or central lobby. I would say that the physical construction was about equal to the Claridge Building. It was not inferior. I would say the Claridge Building would sell for more money than this property in August 1935. I would say the Claridge would average for land and building, \$156,000, or \$157,000. I base this value on my general knowledge, not upon this sale.

I would say it would have been quite difficult to obtain a buyer for \$156,000 for the Claridge Building for August 1935. You would have had to put forth considerable ef-

fort to produce a buyer, to buy at that price at that time.

54 It is the general practice for an appraiser to consider the value of a piece of property from its economic approach. That means the ability of the building to produce a reasonable return. Sales are not always made necessarily on that one basis. They are sometimes made if a person has particular use for a property, they may pay more for it, but in income-producing property such as this there is a very definite rule established as to the approach.

It is a rule as to the amount of money that a building can produce, the gross income, the desirability of the apartments, the question as to whether the neighborhood is on a declining basis or whether it is remaining static or whether rising. It would include the amount of rent you would estimate that your building could bring in. The type of construction would come into the analysis of it. And so doing that, you arrive at what might be considered a stabilized income and then this stabilized net income is computed and worked out where it produces a fair return on the investment and sets up sufficient money to replace the improvement at the end of its life.

I would say the neighborhood is on the decline. There are many factors that have come into the section, such as six apartment buildings have been converted in to rooming houses. There have been a number of those instances in the immediate vicinity. The general character of the people occupying apartments in that section is more or less of the transient type, less desirable, not as permanent, not families.

There is a colored settlement, a number of negro families that have been occupying ten or fifteen buildings, two-story buildings about six or seven blocks from the property. It has an adverse effect on the market value of the real estate. It is a detrimental influence.

We have not considered in this building any income that might be derived from furnishings or the use of furniture in connection with it. We are considering it as an unfurnished apartment building. We believe that is the original intention and it is presumed when the furniture is put into a building after it has been built for a definite purpose it is because the apartments are not rentable as unfurnished apartments. We have disregarded entirely the use

of furnishings in the building outside of the little furniture the lobby would take. We find a stabilized net income as of 1935 in that building of \$16,000 a year.

That is the amount of money left after you have paid all of your operating expenses and salary, your coal, and taxes, all the maintenance expenses, insurance. This is before depreciation.

Then we apply the Babcock system, which is an annuity system. We take the net income, multiply it by a factor which we arrive at by the number of years we believe will be the remaining life of the building. In this case we considered twenty-nine years would be the remaining life. We used an eight per cent factor. Eight percent produces a factor of 9.5458 and multiplying that gives a sum of \$152,732, and to that we add the reversionary value of the land which we consider to have a value of \$26,250, applying the six per cent rate to that, which gives \$4,854, or a total of \$157,577.

Using that approach to arrive at a value one would come to a total value of \$157,577, land and building.

I am considering this cash sale, the cash market value of the property in 1935. You would find it difficult to secure a purchaser for a building of this kind for four times its annual rental unfurnished, gross rental. The value of the land and building on August 1, 1935, talking about the fair market value, what the building could be expected to be sold for if a purchaser could have been found at that date, I would say is \$157,000. I would allocate \$26,250 for the land, the rest of the building. If the property had been sold at that price, I would say that would be a good price as of 1935.

Cross-Examination by Mr. Hamilton.

The Home Owners Loan Corporation dealt only with single family dwellings up to four apartment buildings. It is not much different to find the fair cash value of these buildings than to find a fair cash value of a building of the size of the one in question. It is more or less the same approach. It is a fact that these small buildings can not, as a rule, be used for commercial purposes, but only mostly for homes. However, the corporation made loans on buildings that contained commercial space on the first floor.

56 The building that was sold in December, 1935 was a 69 apartment building. There were thirty-three one room apartments, twenty-four two room apartments, fifteen three, three four room apartments, and three three room apartments in the basement. The lot was 150 by 150. It had individual lobbies. There were no furnished lobbies. They are large vestibules, much larger than the average, but they had the mailboxes in the lobby and in order to get through into the inner part of the building, you had to ring the bell and the door was opened by a buzzer. I do not believe they had any inter-communicating telephone system. I am not sure how many boilers were in the building. I would not be able to answer that definitely. I am not sure what kind of a boiler they had. It was a steam boiler, low pressure boiler. It had a steam heating system. I do not recall what system it had for heating the water for the use of the tenants. It had individual meters for electricity. Each tenant paid for his own light. The building pays the gas as I recall in this case. I would say that the first floor was ten feet above the ground.

I don't believe the Claridge Building has much greater height in its basement than that sir. I think they would be comparable in that height. The distance from the vestibule to the floor of the building across the street from the Claridge I would say is about nine feet. It is not a fact that it is just seven feet in height. I don't just recall the exact height. You will find it pretty close to 9 feet. The lobby is grade level. I don't know how many steps you have to take to get to the basement floor of the Claridge from the ground level, but I would say it was about two feet below grade.

I don't believe there are any cabinets in the bath room of the building across the street from the Claridge. There are very nice china cabinets in the dining room. There is linoleum in the kitchen, but not in the dining room. The fixtures in the bath room in the building across the street from the Claridge are rolled rim porcelain tubs, pedestal lavatories, low tank toilet combinations with Sloan valves and metal type medicine cabinet. I don't think enameled iron was used, but I am not so sure. I think some are enamelled iron fixtures, and some are not. It wouldn't make much difference, however, in the ability of the 57 building to earn. It is up there as an economic unit.

As to whether you have a better chance of getting

better rents for a building if you have a nice lobby and a manager taking the complaints of the tenants like in the Claridge Building, from my experience, I don't believe it makes much difference. After all, you have a manager in the lobby you have to pay their salaries.

Part of the building of the Claridge was partly furnished in 1935. I put my appraisal on the proposition of no furnishings. If it were on the basis of furnished apartments, it would make it a little higher, the difference in the cost of the furniture. However, in the management of buildings of this kind, it is generally conceded good business to get rid of the furniture as rapidly as you can because it is unprofitable.

The reason apartments are furnished is to rent them. I won't say you get a higher per cent of occupancy in furnished apartments. To my knowledge, we have extensive management all over the north side, when we find apartments are not renting, we furnish them and then as soon as the market firms up, dispose of the furniture and rent them unfurnished.

The gross rentals of the Claridge Building in 1935 would not affect my value, because some of that money may have come from the furnished apartments for the use of furniture. Some of it may have come from stores in the building when they were being rented. I testified the stores had been eliminated in 1935, and I presumed it was because of the building ordinance not permitting them, therefore, I did not take into consideration the little income the stores would produce. I presumed they had no economic value—the fact it was in violation of the law to have them.

The transaction in December, 1935 was for \$107,000. I do not know how much mortgage was on it. I don't think there was any distress involved in the sale; not any more than the usual distress that was involved in all sales in 1935. It was not a corporation that owned the building. We acted as advisers and received a fee from the purchaser. I don't recall the owner's, but the purchaser's name was Colonel Bartley. The commission was figured in the \$107,000, we received half of the commission, as I recall it on that basis. This is the only transaction I recall in that neighborhood of a building anywhere near this size in 1935. I would not want to establish my opinion as to the value of the Claridge in August, 1935, on this transaction alone.

The other factors I would want to consider in forming this valuation besides this one sale, are all the factors that are necessary in arriving at the value of a piece of improved property. It must of necessity be the governing factor, regardless of what your approach might be, is the ability of the building to earn. It is a business. The amount that might be represented in brick or mortar in my opinion would be secondary. The quality as I mentioned before, that is a point to be considered and was considered at the time that I made the appraisal on this property,—that the construction of the building was fair. If the Claridge Apartments were vacant at the time I established my value, I would give it the same value as I would have given it now. Having the rental value, knowing what the rental value of the building was, the ability of the building to earn a fixed net income, not in 1935, but for the remaining life of the building, twenty-nine years, I would not say that would be speculative. It would be based upon one's knowledge of real estate over twenty-seven years. It would not be speculative.

You do not have the actual rental value, but you have your opinion of the rental value of the unit. We have lots of buildings we manage right in that neighborhood.

There were 147 rooms in the building that sold in December, 1935. There are 228 plus four apartments in the basement in the Claridge. In the Claridge there were 26 three room apartments, 78 two's, on reconsideration, there were 23, four rooms in the Claridge and they have a basement. There would be 12 rooms in the basement. I haven't considered the shops. They have been later turned into apartments. I don't know how many rooms there might be in the shops. They might possibly get in four or five more rooms in there for the shops. I can't as a real estate man, give the value of a building from the value of each room. This is a going proposition, sir, this is a building that has been built. It has a permanent value. What can you get for the units that you have? The size of the rooms of course will depend somewhat upon what you get in rental for them. But the number of rooms, it so happens in a building of this type, two room apartments, you can get almost as much rent for two room apartments as you can three room apartments in 1935, maybe five or seven dollars difference between the two and three.

When you are figuring that way, you are not figuring

any one particular year, you are figuring the remaining life of the building. I would figure one room almost as much as two on that basis, I would not say it was worth as much, I have said, almost as much. It would not be worth half as much.

As to whether or not the conditions I say exist in 1935 might not exist during the remaining life of the building, you take the cycle of real estate, you could go into the period of 1931, where possibly the rental value would not be as high in 1931. I valued it for 28 remaining years. I would not say one room was worth nearly as much as two over that span of twenty-eight years. I would say the ratio would be, I would say that the difference in the rooms does not work out economically. The additional room is not worth what it costs to produce. It is not worth one-third more.

You rent one room to respectable people who want a home, but haven't much income. I would say you rent a two room, not to a more respectable person, it would be equal. We haven't found there are more changes in a one room apartment than in a two room apartment.

In home neighborhoods the larger the number of rooms in an apartment, as a rule you get a better class of tenants, but this is not a home neighborhood, this is not a family neighborhood. It was 25 years ago, but it is not now.

I do not know how many tenants in this Claridge Building have been there since the building was built in 1924. I am going by principally by observation in the rest of the neighborhood. Most of the buildings in this neighborhood are unfurnished, and the tenants are required to sign a yearly lease in writing. They are under legal obligation to stay in there. It doesn't make very much difference to that class of tenant whether they have a lease or not. If I knew there were twenty tenants in the Claridge who had been there since 1924, that would not alter my belief as to the permanency of the tenants. I would
60 say, among other things, good management.

It wouldn't enhance the value of the building if they were there twenty years, and the chances they might stay twenty years more. You will figure when you put one hundred tenants in a building that some are going to remain a long time, others are going to move before their lease expires and some move out at the expiration of the first lease.

Assuming that there has been testimony by Mr. Henry

that this building had a gross rental of \$43,000, my valuation is three and one half times the rental, \$157,000. I know of buildings in that neighborhood that are bought at three and one half times the gross rental, I would say Mr. Henry's rental,—that was partly furnished. I will sell you a building, sell you one right now, sir, at 4546 Magnolia, sell it for less than three times the rental and that is furnished, however, not unfurnished. The whole building is furnished.

There are twenty-five percent of the 106 apartments furnished. I would sell the Claridge at four times the established income and that is not high, I would think in my opinion. I base my opinion on gross rentals on my knowledge of the various improved properties managed in that section of Chicago.

"Mr. Altman: I would like to point out after all the testimony we have had right here has been that 1940 was a better year, and this whole property sold for \$125,000. Just what are we doing in this case but a lot of talking?"

"Mr. Hamilton: There are a lot of things to be argued about any forced sale. I want to know whether that was the market value here.

"Q. (By Mr. Hamilton.) Mr. Bowers, if you had this proposition put to you that \$43,000 was the gross income of that building in 1935, 1936, 1937, 1938, 1939, 1940; that much or more, would that alter your opinion as to the value of the building?"

"A. If you are giving me something hypothetical, I can't base my opinion.

"Q. I will support it by evidence later on. I want to get your opinion.

"A. I couldn't answer that, sir, unless I had found a building which produced the \$43,000.

"Q. We are talking about the Claridge. Assuming a \$43,000 income from the gross rentals and twenty-five percent of the 106 apartments furnished, and that was a steady income from 1935 to 1940, that was the average stable income, gross income, would that alter your opinion as to the valuation of the building?"

"A. No, it would not."

61. "I would say that three and one half the gross rental is the correct way to figure with a record like that.

"Q. What other features other than income did you use in making this valuation?"

"A. What other features in making this valuation?

"Q. Other than income of this Claridge Building did you use in making the valuation?

"A. I have described that, as analyzing the neighborhood.

"Q. I am talking about any other feature, that is, whether you have considered the construction of the building, the cost of the building, the replacement value.

"A. Not the cost, no, not replacement, or the original. I could not consider."

This figure of \$16,500 net income is my opinion as to what the building will net over the remaining twenty-nine years. The gross income on that basis I figure about \$46,000, I think, what we figure to be the established gross income unfurnished.

"Q. What were the individual items of expense whereby you arrive at a net income of sixteen-five?

"A. I haven't those figures with me, but the net result after paying and setting up the necessary expenses was a net income of \$16,000.

"Q. You use a gross income here of \$46,000 and a net income of \$16,500. The difference is \$29,500. That must be the sum of the expenses. How would you break that down?

"A. I haven't those individual break-downs with me, but they consist of everything that goes into the operation of that building including the replacements of refrigerators and gas stoves and linoleum and repairs to the building, replacement of carpets, new roof, outside painting, decoration, taxes, light, coal, water, janitor, office help, and what not."

I cannot break down this figure of \$29,500 without my notes. We take out figures from the operations of other buildings. We have a number of other buildings, and use them as a guide to the proper cost of operation.

The rule of thumb is that the operating expenses would run from 60 to 65 percent of the gross income.

We check the amount of the taxes and in this case we obtained the figure from the Internal Revenue Department and accepted their figures and it was, I would not want to be definite on this, it seems to me the figure they supplied was somewhere around \$4,500 taxes for 1935. That would be quite general. It might be less and it might be more.

"Q. How much did you allow for janitors?

"A. That would be all figured up. I haven't those figures here before me.

"Q. Can't you figure out from your twenty years' experience how much it would be for a janitor in a building of this size?

"A. I can't give it, no sir."

I would say to operate a 106 apartment building, you would have to have one union man and a helper. I haven't the record of the union scale before me, something like \$3.80 per apartment per month. It would not be \$300 a month for 100 apartments. It would be around that scale, is around \$3.65, but on buildings of this size the union are in the habit of making a rate with the owners. Generally that rate would be fixed at somewhere below the union scale. I think in this case we probably used the figure of \$200. Generally the top figure is \$250 for a building one man can handle alone. That is not for the helper. The helper would be extra. It depends upon the kind of deal you make with the union for the help, or possibly around \$90.00. The two of them together would be \$250 plus \$90.00.

It would not alter my opinion if the janitor got a hundred a month with the basement apartment, and the helper got \$90.00 a month. I would say he is paying him below the union rate.

"Q. If this building made that deal with the union men and they operate on union cards, would that alter your opinion as to the net rental?

"A. No it would not alter my opinion."

I do not know the terms of the deal. Mr. Henry might be a very good dealer, he might be able to deal for a very low wage scale for his employees.

"Q. I am asking you to assume that was the deal. Would that make a difference in your valuation?

"A. No.

"Q. How much do you allow for electrical bills for an apartment building of this size?

"A. I haven't those figures before me. The total cost of operating the building would be about 65 percent of its gross earnings.

63- "Q. I know you are an experienced man. You have come to be an expert in twenty seven years in this neighborhood. Can you give some estimate, not binding, not exact figures, as to what would be the approximate electricity bill for a building of this kind?

"A. I don't want to deal in generalities. I don't believe that is possible here, it would merely be an estimate.

In making my appraisal, the income tax department didn't give me any aid in the way of a list of the bills. I just called up about the taxes.

"Q. Do you or do you not know the approximate cost of the electricity?

"A. I am unable to say.

"Q. How much for coal?

"A. I would not want to estimate it.

"Q. How much would be allowed for coal in the buildings in general in this neighborhood?

"A. I couldn't answer that.

"Q. 106 apartment buildings?

"A. I couldn't answer that.

"Q. How much is allowed for decorating buildings in general, apartment buildings?

"A. That would be all part of your 65 percent of your total cost, the total income. You must remember in any expenses in a building there are many items that do not recur each year but will recur over the remaining life of twenty-nine years, such as replacements of your linoleum, of your floors, such as gas stoves, such as your stair carpets, refrigerators, electric light fixtures, your plumbing fixtures. Many of those have to be replaced. It might not be in your particular calculations, but they are all taken into consideration in connection with determining the cost, the 65 percent of the gross income for operating a building over this twenty-nine year period, and it doesn't make much difference how you operate it, it is there, and everybody knows you have to do it.

I arrive at 65% from our knowledge of operations of buildings of this type.

I would not know what percent of the 65% would be for coal. I can not break down the items of this 65% unless I go back to my office and get the figures. I cannot do it right now.

"Q. Kewanee boilers are used in the Claridge Apartment building. Both are Kewanee boilers. They are Kewanee portable boilers No. 315. I do not know the cost in August 1935 to lay pressed brick per thousand, or what the cost for pressed brick was at that time. Nor do I know the cost of the mason work on this property. I do not know what the cost of the terrazzo flooring per square

feet was in August, 1935 in this building. There is a picture molding in the living rooms of the building.

There are inner door beds in the building. I would not know without checking my notes, what kind of gas stoves were in the building. The common ordinary range found in a place of this kind, four burner. I do not know without checking it. I do not know what kind of flooring in the kitchens of this building. They are covered with linoleum. I don't know what it is. I believe the floors in the dining rooms are hard wood. Oak I would say. I would not say what particular quality of Oak.

Q. Isn't it a fact they are clear oak floors, the very best selected oak?

A. They don't look it. The apartments I saw, very dirty floors, pretty bad shape, I would say.

I do not know of my own knowledge whether there is selected clear oak flooring in this building. I do not know of my own knowledge whether clear select oak floors are in the living rooms of this building. I do not know the cost of lumber in the building on August 1, 1935, in this building, or what would be the cost of lumber. There is medium grade of hardware in this building now. I don't know what the finish is. I do not know the cost of carpenter labor on this building August 1, 1935. I think the hot water heating system for the use of the Claridge tenants is a submerged heater attached to boilers. I do not know what make of pumps they have in the building. I did not notice them. They should have, I imagine, because all buildings have them. The lavatories in this building are low tank pipe combination with Sloan valves. I did not notice the construction of them. I did not examine them. As to whether they are vitreous china, I presume so, I didn't examine them for china. I do not know what would be the cost of the plumbing in this building on August 1, 1935.

I constructed buildings for myself in the City of Chicago. It was stores and apartments, straight apartments. One building had 9 small apartments, small apartments, and two stores, and twelve apartment building, and had an interest in the construction of some others with thirty-six flats. They were located on the North side in Chicago. I haven't the address with me.

We let the contracts to builders as most buildings are built. We constructed the building. We were on the job every day while the building was being built, every day personally.

"I do not know the location of this big building. I do not know when it was built. Nothing in the last ten years, nothing was built in the last ten years.

The stores were built on Lawrence Avenue. I don't recall the exact number of the address. If you want to pin me down, I can't give it to you. I haven't the number in my mind.

I do not know whether this terrazzo floor in the Claridge Apartments building had any cracks in it in 1935. I didn't fix the value of the building in 1935 on the basis of the cracks in the terrazzo floor. I mentioned that as being a point to illustrate it is not a first class constructed building; medium grade.

"Q. Mr. Bowers, it is a fact your appraisal of this building is based entirely upon rentals, the income from the building, and not at all on replacement value, August 1, 1935?

"A. That is right."

Redirect Examination.

I considered the income and the general business conditions at that time and applied to real estate conditions of that time.

Recross Examination.

Your replacement is not to be considered. Buildings are worth when they are built what you can get for them, not what they cost to produce.

"Q. In other words, you don't think the question what it will cost to replace the building is to be considered at all in fixing the value?

"A. It has to be considered, but the replacement cost is not a measuring stick to determine the value."

In other words, in making this value, I did not consider the replacement cost. I could have determined that, but didn't feel it was pertinent to it.

"Q. Therefore it wasn't considered in fixing the valuation, because you didn't know it? Isn't it a fact the Assessor's Office of Cook County in determining the value of properties, buildings, they consider only the replacement cost and not at all the selling price?

"A. Unfortunately, that is true."

I have not done any appraisement for the assessor.

Office, but I have assisted him in all his land values the last fifteen years.

66 The Court: I suggest you make an objection at this point. The reason is—it may not be your fault—that you are departing entirely from rules which are well established in income tax laws as to what is the basis for determining fair market value of property. The fair market value of property, according to the definition which has been described in cases over and over again is the amount a willing buyer would pay a willing seller for the property at the time and under the circumstances.

Mr. Hamilton: At the same time what a willing buyer would pay for it, whether he would consider replacement costs as well as the income feature too, whether that is one of the things that make up what a willing buyer would pay, replacement costs rather than income. That is what I am arguing and not anything else. I think that is all.

Mr. Altman offered photostats of the Complaint in the Assessor's office, consisting of Affidavits and assessments by the assessor. Mr. Hamilton objected to this evidence on the ground that it furnishes no criterion of the value of a building property on the basis of an assessor's valuation and on the further ground that affidavits are not in any way connected with the Petitioner corporation and are not binding on it.

The Court: I don't see anything for it, Mr. Altman, but to sustain that contention unless you can connect them.

The Assessor's Report was offered in evidence over objection, and received, marked RESPONDENT'S EXHIBIT E.

MILTON C. KUEHN, called as witness for respondent, testified:

Direct Examination by Mr. Altman.

My name is Milton C. Kuehn, 1819 Glenview Avenue. My residence is Park Ridge, Illinois. I am a business executive at 310 South Michigan Avenue, Chicago, Illinois. I am employed by Securities Service Corporation.

I was employed by Securities Service Corporation in the years 1935 and 1936. I was an officer at that time in the Securities Service Corporation. I am familiar with the reorganization of the Claridge Building Company and the

transfer of the subject property at 4501 Malden to the Claridge Apartments Company through a 77-B reorganization. I was president then. I signed respondent's Exhibit B, being the 1936 income tax return of the Claridge Apartment Company. This was originally a Straus bond issue and Securities Service Corporation serviced the committee and it was the practice at the reorganization, due to a Trustee's holding the stock, to elect certain members of our organization officers and directors of the corporation. Referring to the schedule in this return marked "Painting and Decorating, \$3,324.87" that amount represents the entire amount spent and actually paid out in the year 1936 for painting and decorating on the 4501 Malden property.

67 Referring to Schedule M entitled "Reconciliation of New Income and Analysis of Changes of Surplus" and Item 6 of that schedule with the following entries—painting and decorating, these two figures for repairs and decorating are included in the three thousand dollar figure that we just talked about on the typewritten schedule.

This \$389.60 I did not refer to in that typewritten schedule. I referred to painting and decorating that may have been included under painting and decorating, although I can't be certain without an examination of the corporate books.

We do not have the corporate books in our possession. We turned them over to Mr. Henry's representative, I believe.

Referring to the return in evidence as Exhibit C for 1937, I did not sign that return. It must have been turned over in the year 1937, I believe. At the time I signed the return in 1936 we did have possession of the books.

It is my testimony that the item in surplus in regard to painting and decorating is included in the typewritten schedule attached to the return. Painting and decorating expenses for federal income tax purposes were treated as deductions in the year in which they were made, whereas the corporate books were on an accrual basis and they were deferred, so much being written off each year, or each month, generally the accrual or the deferment being on a twelve months basis, all leases being on that basis.

The \$1300 item of painting and decorating on Schedule M represents the amount that was deferred on the corporation's books. I can't say as to the repairs, but I am inclined to think, from the way it was handled out here that that was the case.

The practice was to deduct on the income tax return for painting and decorating all expenses in the year covered by the return.

I was connected with Straus & Company in 1924.

Q. What was their practice with regard to floating bonds on these apartment buildings; did they normally float an issue the proceeds of which were sufficient to pay for the entire construction of the building?

Mr. Hamilton: I will object to that. What he does generally has nothing to do with this case.

The Court: Sustained.

68 Q. (By Mr. Altman.) Are you familiar with the general practice of Straus with regard to it in 1924, in floating bond issues on apartment buildings?

Mr. Hamilton: The same objection.

The Court: I sustain the objection.

I recall something with respect to the payment of interest and principal on the bonds, but that is quite a ways back and I don't remember all of the details.

Q. (By Mr. Altman.) Do you remember whether the issue, or do you know whether the bond issue on this property back in 1934, which was \$340,000—is that right, Mr. Hamilton?

Mr. Hamilton: That is what the loan was.

Q. (Continuing.) —\$340,000, whether that \$340,000 bond issue which was handled by Straus Securities represented the entire construction cost of the building put up at 4501 Malden?

Mr. Hamilton: I object. He has not shown any qualification whereby he could know.

The Court: He asked whether he knows, and I assume he will answer the question truthfully. Objection overruled.

A. (By the Witness.) I don't know.

I only recall remotely the reorganization details of the building in 1935. I will have to refer to our files to know more about it.

Three pages of the minute book of the Claridge Apartments Company excerpted from the Director's meeting on July 1, 1935 were offered and received in evidence as Respondent's Exhibit F.

Excerpt from the Board of Directors meeting of the petitioner August 7, 1935, being three pages were offered and received in evidence as Respondent's Exhibit G.

Excerpt from the minutes of the meeting of the stockholders of the petitioner held on September 9, 1935, consisting of three pages were offered and received in evidence as Respondent's Exhibit H.

"Q. (By Mr. Altman.) Now, do you know whether the petitioner, this new company that came out of 77-B of which you were president, actually paid the reorganization expense during the remainder of 1935 or early in 1936, Mr. Kuehn?

"A. They did pay them and I believe it occurred the latter part of 1935. Yes, it was the latter part of 1935.

"Q. There is no doubt in your mind but what they were all completely paid by the early part of 1936?

"A. Oh, yes.

"Q. And your answer is they were?

"A. They were, yes."

69 The bonds of the old company were deposited with the American National Bank. The committee designates the depository. In this case it was the American National Bank. All bondholders who cared to become a party to the plan of reorganization deposited their bonds with the depository. After the court approved the plan of reorganization trust certificates were issued. Whether the American National Bank, the depository, had cancelled the bonds up to this time, I cannot testify. I don't know. These bonds were not turned over to the Securities Service Corporation, or this other company, the Claridge Apartments Company. As to whether Mrs. Case was paid the \$1400 for the furniture, she owned in the building, I don't have a definite recollection on that matter, but I do recall the item coming up.

Mr. Henry: Part of it was paid to her out of the money from the old company and then the balance was paid out of the rents from the new company. The old company, the Claridge Building Company, paid part of the \$1400 to Mrs. Case.

The final decree of the District Court in the 77-B proceedings, dated March 1, 1937 was offered and received in evidence as ~~RESPONDENT'S EXHIBIT I~~.

Cross-Examination by Mr. Hamilton.

Looking at the respondent's Exhibit B, Schedule E, is an item of \$1336.02 that refers to repairs. The rider attached on schedule B gives an item of painting and deco-

rating of \$3,324.87 that refers to decorating. So there were two items, one of repairs and one of painting and decorating separate for that year. That was the amount of the decorating and the amount of repairs that we paid that year. As to whether or not during the year 1936 under my management, certain decorations in the Claridge were incurred and not paid for and the bills not paid by December 31, 1936, I can't testify to that without consulting the books. I wouldn't know. I don't believe that is the case. I filed the return to the government under the accrual basis.

All the repairs and decorating that were paid during the year 1936 were charged as expense against the income, and reported in this return for the year 1936.

70 "Q. And those that were not paid for were carried over to the next year, is that right?

"A. I can't answer that question."

It states in the minutes of the Claridge Apartments Company that there were \$8,000 of accrued money in the treasury of the Claridge Corporation at the time of this reorganization. This \$8,000 was paid out by the new corporation. They were indicated as a disbursement on the books of that corporation. I can't answer whether the \$18,500 was paid out in its entirety by the new corporation without an examination of the books. I believe it was made out by the corporation. It came into that corporation and it had to be disbursed through that corporation. It could not be otherwise. If I remember correctly, it was augmented by the funds that were in the hands of the old corporation at the time of the reorganization, and it was used to pay general real estate taxes, and reorganization expenses approved by the Court. And included in that is whatever nominal costs there may have been of organizing this new corporation, Claridge Apartments Company, I suppose.

"Q. Weren't there attorney's fees for it and also state fees you had to pay out of it?

"A. Well, yes,—I am not sure about that, for this reason: I don't know whether that came out of the general till or whether it was earmarked reorganization expenses or not. The books of course, will reflect that and I don't have access to these books.

"Q. As part of the reorganization it was required to organize this Claridge Apartments Company before the

reorganization was complete so it could accept the title to the property, was it not?

"A. Yes, I think that is true."

As to the books of Claridge Apartments Company for the year 1937, Mr. Hamilton states:

We have not got possession of the ledger, but I think we have all other books, that is the daily receipts. From November on, we have them.

Your Honor, the only book he asked me to produce was the ledger account for the year 1937. I have searched all over creation, all through the loop in every office I know in my office and the Claridge Corporation, Claridge Apartments Company office, and I couldn't find any book. He did not make any general request to produce all the books, only that one book, that I know anything about.

Respondent Rests.

71 MR. CHARLES F. HENRY recalled as witness on behalf of Petitioner testified on direct examination as follows:

I am the same Charles F. Henry who testified yesterday in this case. I examined the building Mr. Bowers testified about yesterday that was sold in December 1935. I examined it about twice every year. I examined it in 1935.

Comparing it with Claridge Apartments Company building, the building is inferior to 4501 Malden Street in construction. The basement is entirely unfinished there excepting the janitor's apartment in it. The vestibule is seven feet high, and not nine feet high, as Mr. Bowers testified yesterday. If they were nine feet high, as he testified, it would put the building in a different class, according to city ordinance, and would make a fireproof building in entirety out of the whole building; the Claridge Building, the entire first floor, is finished and there is a very expensive lobby there, and it is a higher building, because we have to go down five steps into the lobby.

The building had been handled by a trustee, the 4512 Malden Street building I am referring to now, and the plaster was badly cracked in many of the apartments, and it needed decorating very badly, and the building was in a general run-down condition. The fixtures were very inferior. They had those little stoves, what we call the

small cookers, and they had a very cheap refrigerator, and so on. The fixtures throughout the building were inferior to the 4501 Malden Street Building.

It is not as good in value per room per flat as the Claridge Apartment Building and the rents, comparing them with Malden Street, were a little bit lower.

The last I checked the building to compare the rents with 4501 Malden Street which was across the street, they were lower.

As to my experience in buying trust certificates from Straus Securities Company, if they had a Claridge certificate offered to them for sale, they would call me up and say, "Regarding the Claridge certificates, I have ten shares. Do you want to buy them?" I said "All right, how much do you want for it?" They would say, "\$24. a unit, or \$40. a unit." I wanted to buy those units, so 72 I paid that to them, what it cost them. I don't know.

Straus & Company bought them. I would buy them from Straus & Company direct and the difference was theirs. They might make five points and they might make ten points profit out of that share. I never knew what they paid for them, but I know I paid for them up as high as \$35. per unit.

As to the terrazzo floor in the Claridge Apartment Building lobby being cracked, as I explained yesterday, the Claridge lobby is very large and the terrazzo floor is made in one slab. Now if any part of that slab should settle just a fraction of an inch it would cause a little twist and a crack there. When cement sidewalks are laid, or streets are laid they always cut the cement in the street or the sidewalk so if there is a little settlement, which there always is, it would not cause a crack, it would not twist and it would not crack. It is impossible to put a foundation in such a large area in one slab over a period of years, and not have a small crack here or there.

There is no cornice and no mold in the living rooms in the Claridge Apartments.

The Claridge Apartments gives to its guests or tenants what we call a hotel service. If they want a maid we furnish a maid. We have a switchboard for the building, and if anyone wants to call in during the day, we take the messages for them. If they want a telephone call in their apartments, we call them down. If parcels come in we receive them, pay the money for the parcels for them. We give them what we call hotel service.

They do not have that in the building across the street. In the building across the street they have enameled iron plumbing throughout. In the Claridge they have vitreous china, which costs just about double what enameled iron costs. The apartment fixtures are vitreous china.

Cross-Examination by Mr. Altman.

I accompanied Mr. Bowers in his examination of the Claridge Apartments yesterday. I did not let him in the building; Mr. Bowers had been over there once or twice. I was up there the other evening, Tuesday and Mr. Bowers came over there. I happened to be there and he was checking, he was standing in the lobby, in the vestibule there. I went into some of the apartments with him, and showed him whatever he asked to see. Part of the plumbing in the building was vitreous enamel, and the rest of it enameled iron, the same as across the street.

Mr. Hamilton: I have just one question.

Redirect Examination by Mr. Hamilton.

"Q. Assuming, as Mr. Bowers did, that the rents were \$46,000, the rents expected from this building a year, what would be the expected and reasonable cost of operating the building generally, or of any building generally throughout the country, in your opinion.

"A. The same size building, \$14,500 without taxes, and he, Mr. Bowers, assumed the taxes were \$4500.

"Q. Assuming Mr. Bowers' figure of \$4500 probably taxes, in a building of this kind, the net rents would be how much?

"A. \$26,500.

"Q. And applying the percentage of valuation of—did he say 9.546 on that? What would be the value of the ground and building?

"A. \$256,500.

"Q. And what in your opinion would be expected to be the cost of the lot; what would be the net value of the building?

"A. \$241,000 plus.

—All Rest.

74 The foregoing is the substance of all the evidence, oral and documentary, adduced at the hearing of the

proceeding by the United States Board of Tax Appeals (now the Tax Court of the United States), and the taxpayer, Claridge Apartments Company, tenders and presents the foregoing as a statement of the evidence in the cause and prays that the same be made a part of the record on review.

Walter Hamilton,

Counsel for Petitioner on Review.

The above and foregoing statement of evidence contains the substance of all the evidence material for a review of the rulings and decision assigned as error herein by the petitioner on review.

J. P. Wenchel,

J. P. Wenchel,

Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent on Review.

75

PETITIONER'S EXHIBIT NO. 3.

The Plan of Reorganization, Included Herein Has Not Been Approved or Disapproved by the United States District Court Which Authorized Its Submission to Bondholders and Stockholders for Their Consideration.

Reorganization Plan.

This agreement made and entered into this 27th day of November, 1934 by and between

George W. Rossetter,

Jay C. McCord,

Sidney H. Kahn,

not personally, but as the Claridge Apartments First mortgage Bondholders' Committee constituted under deposit agreement dated September 9, 1931, party of the first part, (hereinafter referred to as the "Committee"),

Claridge Building Corporation, an Illinois corporation, party of the second part, (hereinafter referred to as the "Owner"), and

Minnie H. Case,

party of the third part,

Witnesseth:

On March 25, 1924, Claridge Building Corporation issued its 6½% first mortgage bonds in the aggregate principal

amount of \$340,000.00 and to secure the payment of said bonds and the interest coupons pertaining thereto, executed its trust deed and chattel mortgage to Melvin L. Straus as Trustee, dated March 25, 1924, conveying the property known as the "Claridge Apartments" located at the Northeast corner of Malden Street and Sunnyside Avenue, Chicago, Illinois. First mortgage bonds in the amount of \$277,000.00 remain outstanding and unpaid. Defaults, occurred in the payment of principal and interest on these bonds and the Trustee, on October 1, 1931, filed his bill of foreclosure in which all of the bonds were declared immediately due and payable. A decree of foreclosure was entered on February 19, 1932 but no sale of the property has been had. The Committee was organized on September 9, 1931 in order to protect the interests of the first mortgage bondholders and the Committee now has on deposit with the Depository \$258,600.00 of the bonds or approximately 93% of the total outstanding issue.

Minnie H. Case has represented to the Committee that she is the record holder of the title to the property but that she is holding title to the property for the use and benefit of Claridge Building Corporation. Certain of the apartments in the building have been furnished with furniture, linens and other equipment and Minnie H. Case has represented that she is the owner of such furnishings, except in those apartments which have been furnished by the Trustee. The Trustee is and for some time past has been in possession of the property and has collected the rents.

On June 16, 1934, Claridge Building Corporation filed its petition in the District Court of the United States for the Northern District of Illinois, Eastern Division, Number 56230, under Section 77 B of the Bankruptcy Act as amended, in which it asked that a reorganization be completed pursuant to the provisions of said Bankruptcy Act. All of the parties hereto have agreed upon a plan of reorganization which they are ready to submit to creditors and to the court in said proceeding under Section 77 B for their approval.

Now, Therefore, in consideration of the premises, 76 and of the mutual covenants and agreements of the parties hereto, the parties hereto do hereby agree to the following plan of reorganization:

1. A new corporation shall be organized under the laws of the State of Illinois with an authorized capital stock

consisting of 3,080 shares of common stock without par value, or with such par value as may be agreed upon by the parties hereto. Upon completion of the reorganization, Minnie H. Case shall convey title to the property to said new corporation and the corporation shall execute a confirmatory quit-claim deed to the new corporation. 2,770 shares of the common stock of the new corporation shall be issued to three Trustees to be selected by the Committee subject to the approval of the court. Trust certificates shall be issued to the holders of the first mortgage bonds and each first mortgage bondholder shall receive a trust certificate representing one share of stock for each \$100.00 in face amount of bonds owned by him. The stock so issued to said Trustees shall constitute 90% of the outstanding stock of the new corporation. 10% of the outstanding stock of the new corporation shall be issued to or upon the order of the Owner.

2. The new corporation will enter into a trust agreement with the three Trustees. The trust agreement shall endure for a period of ten years subject to termination in the manner herein described. Not later than sixty days prior to the expiration of the first two-year period of said Trust, the Trustees shall call a meeting of all trust certificate holders, or in lieu of such meeting, shall conduct a referendum of all trust certificate holders for the purpose of determining their wishes as to the termination of the trust. In the event that 51% or more in amount of the certificate holders vote in favor of the termination of the trust, then and in such case, the trust shall be dissolved as of the date of the end of the first two-year period and the stock of the new corporation in the name of the three Trustees shall be transferred and issued pro rata to the then holders of the trust certificates. If the holders of 51% or more in amount of the trust certificates do not vote in favor of the termination of the trust, then the trust shall continue. If at the expiration of the first two-year period the trust is continued as hereinabove provided, then a similar meeting or referendum shall be held prior to the end of the second two-year period to determine whether the trust shall be then terminated, in the same manner as hereinabove provided at the end of the first two-year period. Similar meetings or referenda shall be held prior to the end of each two-year period to determine whether the trust shall be terminated at the end of such period,

unless the trust shall theretofore have been terminated by the certificate holders or by a majority of the Trustees who shall have the power to terminate the trust at any time. In any event, the trust shall terminate at the expiration of ten years from the date of the original trust agreement. The committee shall nominate three persons to serve as the original Trustees, but said Trustees shall be satisfactory to the court. The Committee shall also designate the Depositary of the Trustees. Any vacancy among the Trustees shall be filled by the remaining Trustees. The Trustees shall have the right at any time to remove the original depositary and to appoint a successor depositary. The trust agreement shall provide that any of the Trustees may be removed and a successor Trustee appointed at any time upon the written direction of a majority in amount of the holders of the outstanding trust certificates. The Trustees shall be entitled to receive usual and reasonable compensation for their services, but the annual compensation of the Trustees in the aggregate shall not exceed 4% of the gross income of the new corporation. The Depositary shall be entitled to receive reasonable compensation for its services, which compensation shall not exceed the regular fiduciary charge for such services. The compensation and expenses of the Trustees and their Depositary shall be paid by the new corporation. The Trust agreement shall be in form satisfactory to counsel for the Committee.

77 3. The trust agreement shall provide that the Trustees shall not vote the shares of stock held by them in favor of a resolution authorizing the sale or mortgage of the property unless written notice of the terms and provisions of the proposed sale or mortgage has been given to all certificate holders at least thirty days before the date of the meeting of stockholders at which it is proposed to vote upon such proposed sale or mortgage, and the Trustees shall not vote in favor of any such proposed sale or mortgage if one-third or more in amount of the holders of the trust certificates dissent in writing from such proposed sale within thirty days after the giving of such notice. The Trustees shall also have the power to sell the shares of stock held by them; but the trust agreement shall provide that the Trustees shall not sell the shares of stock held by them unless written notice of the terms and provisions of the proposed sale has been given to all certificate holders at least thirty days before

the date of the proposed sale, and the Trustees shall not sell such stock if one-third or more in amount of the holders of the trust certificates dissent in writing from such proposed sale within thirty days after the giving of such notice. The Trustees shall have the right to apply to any court of competent jurisdiction for its approval before completing any sale or mortgage of the property or before completing any sale of the stock held by them, but shall not be required so to do.

4. The new corporation shall by written agreement indemnify the present Trustee under the bond issue against any and all liability which he may suffer or incur by reason of his operation of the property (other than for wrongful acts of the Trustee) and against any and all taxes, assessments or other governmental charges which may be levied or assessed against him covering the period of his possession of the property. The new corporation shall also by written agreement indemnify the Committee against any and all taxes, assessments or other governmental charges which may be levied or assessed against it and against any and all liability which may be suffered or incurred by the Committee by virtue of the reorganization plan, including the expenses and reasonable attorneys' fees in the event that litigation is instituted against the Committee or any member thereof.

The new corporation shall assume and agree to pay the reorganization expenses hereinafter referred to and these expenses shall be paid in full before any dividends shall be declared or paid upon the stock of the new corporation. Subject to the approval of the court, the following reorganization expenses shall be allowed:

(a) To cover the general expenses and compensation of the Committee including the charge of Securities Service Corporation 1% of the face amount of deposited bonds plus out-of-pocket expenses;

(b) Charge of the Depositary on the basis of three-fourths of 1% of the face amount of deposited bonds plus out-of-pocket expenses;

(c) Compensation of counsel for the Committee;

(d) Compensation of counsel for the owner.

In addition there shall be allowed the expenses and charges in the foreclosure proceeding, including the Trustee's fee, the fee of Trustee's counsel, court costs and Master's fees. There shall also be allowed and paid the actual expenses to be incurred in connection with the organization.

of a new corporation, printing of the trust agreement and the new securities, stamp taxes, title guaranty expenses, court costs in the bankruptcy proceeding and other similar items.

Upon consummation of the reorganization, the present Trustee shall surrender possession to the new corporation and all net assets of the Trustee over and above the liabilities of the Trustee in connection with the operation of the property shall be applied towards the payment of the reorganization expenses.

78. 5. Upon consummation of the reorganization, Minnie H. Case shall execute and deliver to the new corporation a bill of sale covering all of the personal property in said premises owned by her. The new corporation shall pay to Minnie H. Case for said personal property, the sum of \$1,400.00, which amount shall be payable to her without interest monthly, in payments equivalent to 20% of the rental collected from the apartments in which the said personal property is located, commencing on the date the reorganization is completed. Until said reorganization is completed, the present agreement between Melvin J. Straus, Trustee, and Minnie H. Case, covering the rental of personal property shall continue and said Minnie H. Case shall keep all of said personal property in good condition and repair. She shall not be required to make replacements of a permanent nature other than replacing linen to the extent that may be required.

6. The new corporation shall enter into a management contract with Minnie H. Case. Said contract shall provide for compensation to her equal to 5% of the gross collections payable monthly and in addition, the manager shall be entitled to the use of a three-room apartment for herself or an assistant manager without charge. Said contract shall be subject to termination at any time that the trust is terminated. In the event that the Trustees are dissatisfied with the management of Minnie H. Case, they shall have the right to discharge her as manager and to terminate the contract, provided that the then President of the Chicago Real Estate Board, or any person designated by him, shall agree with the Trustees that the services of the manager are unsatisfactory after a hearing at which the manager shall be entitled to be heard. Said management contract shall provide for the personal services of Minnie H. Case and shall be non-assignable and shall terminate upon the death or disability of Minnie H.

Case. The compensation of any resident manager employed by the manager shall be paid to her. The funds collected by the manager shall be deposited in a bank satisfactory to the Trustees in a special account entitled "Name of corporation—Minnie H. Case, Manager" and the manager shall account to the new corporation on or before the tenth day of each month for all moneys collected during the preceding month. The manager shall be required to furnish a Fidelity bond in a company satisfactory to the Trustees in an amount equal to not less than two months gross income from the property, but the cost of such Fidelity bond shall be chargeable against the property.

7. The new corporation shall have three directors and so long as Minnie H. Case is alive and so long as the trust continues, said Minnie H. Case shall at all times be one of the three directors. In the event of the death of Minnie H. Case while the trust continues, the holders of 10% of the stock originally issued to Minnie H. Case shall thereafter have the right to elect one director during the continuance of the trust.

8. The Committee will submit the plan of reorganization to all depositing first mortgage bondholders and will file claims on their behalf and will also file the necessary consents to the plan of reorganization on behalf of depositing first mortgage bondholders. The corporation will file the plan of reorganization in the said bankruptcy proceedings and will consent thereto.

Unless all of the persons having any right, title, interest, lien or claim in or to the above mentioned property consent to and approve of the plan of reorganization or accept the new securities hereinabove provided for, it is distinctly understood and agreed that the approval of the plan of reorganization by the first mortgage bondholders consenting thereto and or the acceptance by first mortgage bondholders of the new securities hereinabove provided for, are expressly conditional upon the entry of a valid order or decree confirming or approving the plan of reorganization, binding upon direct or collateral attack on all the persons who have any right, title, interest, lien or claim in or to the above mentioned property, whether or not such persons consented to said plan of reorganization, or whether or not they accepted any benefit thereunder. If, for any reason the order or decree hereinabove referred to shall be reversed, set aside, or held void or invalid, all of the first mortgage bondholders

consenting to the plan of reorganization or taking any benefit thereunder, shall be restored to their former rights, title, lien or claim in and to said property as if this plan of reorganization had never been in existence.

9. It is understood that in executing this agreement the Committee does so solely as a Committee and not as individuals and only pursuant to and in connection with the powers granted to the Committee by the terms of said deposit agreement subject to all the rights of depositing bondholders as set forth in said deposit agreement. It is further understood that no individual member of said Committee shall be deemed personally bound by any covenant, undertaking or agreement herein, and no personal liability or personal responsibility is assumed by nor shall at any time be asserted or enforced against the members of the Committee either individually or collectively by reason of any of the provisions hereof or by reason of any action or non-action taken or permitted to be taken pursuant to the provisions hereof.

George W. Rossetter,

Jay C. McCord,

Sidney H. Kahn,

*Not personally but as the Claridge
Apartments First Mortgage
Bondholders' Committee.*

Claridge Building Corporation,

By Albert A. Henry,

Vice President.

Minnie H. Case,

(Seal)

Attest:

Howard D. Henry,

Secretary.

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PETITIONER'S EXHIBIT NO. 4.

IN THE DISTRICT COURT OF THE UNITED STATES

For the Northern District of Illinois,

Eastern Division.

In the Matter of	}	No. 56230.
Claridge Building Corporation,		
a corporation,		
Debtor:		

PROOF OF PUBLICATION AND MAILING.

State of Illinois, }
County of Cook. } ss.

Violet Sundling, being first duly sworn deposes and says that she is the duly authorized agent of the Claridge Building Corporation, the debtor above named, and that pursuant to paragraph 10 of an order made and entered herein on the 10th day of December, 1934, aforesaid accompanied by a copy of the proposed plan of reorganization, a true copy of which is attached hereto, and marked Exhibit C, together with appropriate forms of proof of claim, true copies being attached hereto, and marked Exhibits D and E, by enclosing the same in stamped, addressed envelopes, addressed to each of the said creditors and stockholders at the addresses indicated on Exhibit B attached hereto, and depositing the same on the 15th day of December, 1934 duly sealed, in the United States Mail Box, located at 110 So. Dearborn St., in the City of Chicago, County of Cook and State of Illinois.

(signed). Violet Sundling.

Subscribed and sworn to before me this 19th day of January, A. D., 1935.

(Seal)

(signed) Cornelia Nye,
Notary Public.

PETITIONER'S EXHIBIT NO. 5.

IN THE DISTRICT COURT OF THE UNITED STATES.

(Caption—56236)

ORDER APPROVING REPORT OF SPECIAL MASTER ALLOWING CLAIMS AND ATTORNEYS' FEES AND CONFIRMING PLAN OF REORGANIZATION.

At Chicago, Illinois, in said District this 14th day of May, A. D. 1935, before the Honorable Philip L. Sullivan, Judge of the United States District Court for the Northern District of Illinois, Eastern Division.

This matter coming on to be heard pursuant to order entered herein on the 10th day of December, 1934, on the motion of the Debtor above named, for an order herein approving the Report of Edmund D. Adcock, Referee in Bankruptcy as a Special Master, with respect to claims filed, acceptances of the plan of reorganization, the plan of reorganization and fees for counsel, which were referred to him pursuant to the aforesaid order of December 10th, 1934, and the order entered herein on the 30th day of January, 1935, and upon the Debtor's motion for an order confirming the plan of reorganization proposed and filed by it herein and submitted to its creditors and stockholders pursuant to the aforesaid order of December 10, 1934, and for a further order authorizing and directing Claridge Building Corporation, the Debtor above named, Minnie H. Case, and Claridge Apartments First Mortgage Bondholders' Committee, to carry said plan of reorganization into effect; and it appearing to the Court that the provisions of said order of December 10th, 1934, with respect to the giving of notice and publication of this hearing, of the classification of claims and of the time and manner in which claims and objections thereto may be filed, of the time within which and the method of filing objections to and acceptances of the plan of reorganization herein, and the mailing of a copy of said plan of reorganization together with a copy of the said notice have been complied with; and the Court having examined the Report of Edmund D. Adcock, Referee in Bankruptcy as a Special Master, together with the exhibits therewith

submitted, and having heard the statements of counsel for the Debtor and for the Claridge Apartments First Mortgage Bondholders' Committee, and being fully advised in the premises, the court doth:

Find, Order, Adjudge and Decree as Follows:

1. That the Report of Edmund D. Adeock, Referee in Bankruptcy, as a Special Master, this day presented herein with respect to claims and acceptances of the plan of reorganization filed herein, the plan of reorganization, and the allowance of fees of counsel for the Debtor and for the Claridge Apartments First Mortgage Bondholders' Committee, be and the same hereby is in all things confirmed and approved.

2. That the following claims filed herein and reported upon by the Special Master aforesaid, be and the same hereby are allowed herein as claims within Class A-1 of claims as classified by paragraph two (2) of the order entered in these proceedings on the 10th day of December, 1934, in the amounts herein designated:

Claim No. 10 filed by Louis J. Behan	\$1,250.00
Claim No. 11 filed by Melvin L. Straus as Trustee	1,050.98
Claim No. 124 filed by Altheimer, Mayer, Woods & Smith	2,970.00

3. That the following claims filed herein and reported upon by the Special Master aforesaid, be and the same hereby are allowed herein as claims within Class A-2 of Claims as classified by paragraph Two (2) of the order entered in these proceedings on the 10th day of December, 1934, in the amounts herein designated:

Claim No. 1 filed by Katie Greer	500.00
Claim No. 5 filed by Edward B. Fogtman	1,000.00
Claim No. 6 filed by Melvin L. Straus as Trustee	16,400.00

83 Claim No. 7 filed by George W. Rossetter, J. C. McGord, and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee constituted under the Deposit Agreement dated September 9th, 1931

Claim No. 8 filed by Mrs. Dee Levine	500.00
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4. That the following claims filed herein and reported upon by the Special Master aforesaid, be and the same hereby are allowed herein as claims within Class B of

claims as classified by paragraph two (2) of the order entered in these proceedings on the 10th day of December, 1934, in the amounts as follows:

Claim No. 2 filed by Minnie H. Case, owner and holder of 198 shares of the common stock of Debtor corporation.

Claim No. 3 filed by Howard D. Henry, owner and holder of 1 share of the common stock of Debtor corporation.

Claim No. 4 filed by Albert A. Henry, owner and holder of 1 share of the common stock of Debtor corporation.

5. That the plan of reorganization proposed by the Debtor has been accepted by the holders of all of its outstanding common stock consisting of two hundred (200) shares, said acceptances having been filed within the time and in the form specified by the order entered herein on the 10th day of December, 1934.

6. That the plan of reorganization proposed by the Debtor has been accepted by George W. Rossetter, J. G. McCord, and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, pursuant to Deposit Agreement dated September 9th, 1931, as amended, as the legal holders and owners of Two Hundred Fifty-Eight Thousand Six Hundred Dollars (\$258,600.00) in principal amount of first mortgage bonds deposited with the American National Bank and Trust Company of Chicago, the depository named and designated in the Deposit Agreement afore-said, which acceptance was filed on behalf of the depositing bondholders representing more than ninety-three (93%) percent in amount of the unpaid first mortgage bonds of the Debtor corporation.

That no objections were filed to the reorganization plan by any creditors or stockholders.

84 7. That the Debtor is not a utility subject to the jurisdiction of a regulatory commission and the provisions of subdivision (e) 2) of Section 77 B of the National Bankruptcy Act as amended, do not apply to it.

8. That the plan of reorganization as hereinafter amended is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders of the Debtor corporation; and is feasible and is a plan within the contemplation of and complies with the provisions of subdivision (b) of Section 77 B of the National Bankruptcy Act as amended; that it has been accepted

in writing after the filing of the petition of the Debtor herein, and pursuant to the order entered in these proceedings on the 10th day of December, 1934, on behalf of creditors holding more than two-thirds in amount of claims of each class whose claims have been allowed and are to be affected by the plan, and by all of the holders of the common stock of the Debtor corporation; that all amounts to be paid by the Debtor or by the corporation acquiring its assets, pursuant to the plan of reorganization herein, and all amounts to be paid to the Committee, whether or not by the Debtor or the new corporation, for services or expenses incident to the reorganization, have been fully disclosed in paragraph 4 of the reorganization plan and are reasonable.

9. That the general expenses and compensation of the Committee, including the charge of Securities Service Corporation, as set forth in subdivision (a) of paragraph 4 of the reorganization plan, are hereby found to be reasonable charges to be assumed and paid by the new corporation to be formed pursuant to the reorganization plan, solely because of the contribution of the members of the Committee and Securities Service Corporation to the formation of the reorganization plan in that they devoted their time and efforts in lengthy negotiations with the debtor and its representatives and other parties in interest, which ultimately resulted in the formulation of a feasible reorganization plan, and will be required to devote considerable time in the future in the completion of these proceedings, and in the formation of the new corporation and carrying out all the terms and provisions of the reorganization plan so that its full intent and purport may be accomplished, and that the approval thereof applies to this cause only and shall not be construed as a recognition or approval by this court of the legal right of the said Committee to make any charge for its services because of the terms of the Deposit Agreement dated September 9th, 1931, as amended.

10. That the plan of reorganization as hereinafter amended, and its acceptance by creditors and stockholders are in good faith and have not been made or procured by any means or promises forbidden by the National Bankruptcy Act as amended, and that all provisions of Section 77-B of said Act relating to said plan of reorganization and the confirmation thereof, have been duly complied with

to make the same effective and binding upon the Debtor and all of its creditors and stockholders whether or not their claims have been filed herein.

11. That the plan of reorganization proposed by the Debtor is hereby amended in the following particulars:

(a) Prior to the Distribution of the new securities to the bondholders, a referendum shall be conducted of all known bondholders to determine their wishes as to the creation of a stock trust as provided for in the present reorganization plan. If a majority in amount of the bondholders who vote, shall vote in favor of the trust, then the trust will be created and trust certificates issued in accordance with the present plan. If a majority in amount of the bondholders who vote, shall vote against the creation of a stock trust then the stock provided to be issued under the plan for the benefit of the first mortgage bondholders will be issued directly to the bondholders without a trust.

(b) If a stock trust is created, the present plan provides for a referendum at the expiration of each two years to determine whether the trust shall be continued, and provides that the trust will be terminated if a majority in amount of the certificate holders vote in favor of termination. The present plan is hereby amended to provide that if a majority in amount of those voting are in favor of termination, then the trust is to be terminated.

(c) If a stock trust is created, any certificate holder is to have the right at any time to receive the actual stock represented by his trust certificate upon surrender of the trust certificate and payment of the transfer taxes and the actual expense of transfer. Similarly, the Trustees are to have the right to require any certificate holder to accept his stock and surrender his trust certificate for cancellation.

(d) If a stock trust is created, certificate holders are to have the same rights with respect to examination of the books and records of the new corporation and with respect to the books and records of the Stock Trustees as are provided for stockholders of a corporation under the

86 Laws of the State of Illinois; provided, however, that no holder of a certificate known to be held directly or indirectly for the present owner of the property shall have the right to examine the record of the names and addresses of certificate holders.

12. That the plan of reorganization proposed by the

Debtor, as amended in the preceding paragraph, should be and hereby is approved, and confirmed and decreed to be in full force, virtue and effect as a feasible plan offered and accepted pursuant to and within the contemplation of Sections 77 A-B of the National Bankruptcy Act as amended.

13. Claridge Building Corporation, the Debtor herein, Minnie H. Case and George W. Rossetter, J. C. McCord and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, are hereby authorized and directed to prepare and execute such documents or other instruments in writing as may be incidental, necessary and advisable to fully comply with and carry out the provisions of the plan of reorganization proposed by the Debtor as amended in paragraph 11 of this order, including the formation of the new corporation contemplated and provided for in paragraph one (1) of the plan, the execution and delivery of the trust agreement under the terms and conditions and subject to the restrictions contained in paragraphs two and three (2 and 3) of the plan of reorganization, and the amendments thereof set forth in paragraph 11 of this order, the actual expenses to be incurred in connection with the organization of the new corporation, printing of the trust agreement and the new securities, title guaranty expenses and other similar items to be assumed and paid by the new corporation, and this Court hereby retains jurisdiction to supervise and approve the preparation and execution of such instruments in writing, documents, certificates of incorporation and other documents necessary and incidental to the consummation of the plan of reorganization as amended and to pass upon and approve the same and the provisions therein contained.

14. Melvin L. Straus as Trustee, under that certain trust deed and chattel mortgage dated March 25th, 1924, from Claridge Building Corporation, the Debtor herein, which trust deed and chattel mortgage was filed for record in the office of the Recorder of Deeds of Cook County, Illinois, on the 31st day of March, 1924, as document No. 8340647, is hereby directed to release said trust deed by appropriate release deed within ninety (90) days from the date hereof unless such period be hereafter extended by order entered herein, and if prior to the expiration of the said ninety (90) day period or extension

thereof, said Melvin L. Straus as trustee has not released the said trust deed and chattel mortgage then, Edmund D. Adeock is hereby appointed Special Master in Chancery for the purpose of releasing said trust deed and chattel mortgage and is hereby authorized, empowered, and directed to execute, acknowledge, and deliver an appropriate release deed releasing the lien of the said trust deed and chattel mortgage; that all of the bonds and interest coupons secured by said trust deed and chattel mortgage are hereby declared to be satisfied and of no further force and effect, and the holders thereof shall be entitled only to receive the new securities provided for in said plan of reorganization as amended, and each and all of the holders and owners of bonds and interest coupons, payment of which is secured by said trust deed and chattel mortgage, whether deposited with the depository named and designated in the Deposit Agreement aforesaid or not, shall be and they hereby are forever jointly and severally enjoined from commencing or prosecuting any proceedings of any nature whatsoever either at law, in equity or otherwise against the Debtor, its successors and assigns, or against any of the property of the Debtor or any of said bonds and or interest coupons and or said trust deed and chattel mortgage.

15. George W. Rosseter, J. C. McCord and Paul Steinbrecher, who have been nominated by the Claridge Apartments First Mortgage Bondholders' Committee to serve as the original Trustees under the trust agreement provided for in the plan of reorganization as amended, be and they hereby are approved and confirmed to serve as such Trustees.

16. That Claridge Building Corporation, the Debtor, Minnie H. Case and George W. Rosseter, J. C. McCord, and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, shall report in writing to this Court on or before the 1st day of July, 1935, all acts and things done and performed by them in the execution and confirmation of said plan of reorganization as amended, and the documents executed by them incidental and necessary thereto; and this cause is hereby continued until said date at the opening of Court without further notice, for the purpose of examining and confirming said report.

17. That Melvin L. Straus as Trustee aforesaid who

is now in possession of the premises of the Debtor known as "Claridge Apartments", being the premises referred to and described in the plan of reorganization, he and he hereby is directed to file his report and accounting within twenty (20) days from the date hereof and upon approval thereof he is directed to surrender possession of the property to the new corporation to be formed as provided for in the plan of reorganization as amended, and within five (5) days subsequent to the completion of the organization thereof, and to pay to the said corporation all cash on hand and to assign to it all accounts receivable, the new corporation to assume the accounts payable of the said Melvin L. Straus as trustee aforesaid, if any there may be, and shall also deliver to the new corporation the books and records necessary to carry on the management and operation of the "Claridge Apartments", the property mentioned and described in the plan of reorganization.

18. The Court reserves jurisdiction herein to enter such further order as may hereafter be deemed necessary and proper in connection with carrying out the terms and provisions of the amended plan of reorganization as approved and confirmed herein and terminating the cause.

Enter:

Judge.

Dated this 14th day of May, 1935.

89. PETITIONER'S EXHIBIT NO. 6.

IN THE DISTRICT COURT OF THE UNITED STATES.

• • (Caption--56239) • •

ORDER APPROVING DOCUMENTS.

This cause coming on to be heard on the Petition of George W. Rossetter, J. C. McCord and Sidney H. Kahn; not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, for the entry of an order approving the following documents and all the provisions thereof, prepared by the Petitioners as contemplated by the Plan of Reorganization heretofore confirmed herein and pursuant to the provisions of the order confirming said Plan of Reorganization, copies of which

documents are attached to said Petition as Exhibits A to F; both inclusive:

1. Certificate of Incorporation of the new corporation.
2. Trust Agreement (including Trust Certificate form of which is contained in Pages 2, 3, 4, and 5 of the Trust Agreement, copy of which is attached to the Petition as Exhibit B).
3. Management contract between the new corporation and Minnie H. Case.
4. Surrender Agreement between Melvin L. Straus, as Trustee, and the new corporation.
5. Indemnification agreement between the new corporation and Melvin L. Straus, as Trustee.
6. Indemnification agreement between the new corporation and Claridge Apartments First Mortgage Bondholders' Committee.

And the Court having examined the said petition and the exhibits A to F, both inclusive, attached thereto, and having heard the statements of counsel and Claridge Building Corporation, the debtor herein, and Minnie H. Case having approved all of said documents, and the Court being fully advised in the premises, Doth Order:

1. That all of the documents hereinabove referred to, copies of which are attached to said Petition as Exhibits A to F, both inclusive, including the form of Trust Certificates contained on Pages 2, 3, 4, and 5 of the Trust Agreement, copy of which is attached to the petition as Exhibit B, and all of the provisions thereof, be and the same are approved in all respects;

2. That the Claridge Building Corporation, the Debtors herein, Minnie H. Case, and George W. Rossetter, J. C. McCord and Sidney M. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, be and they hereby are authorized and directed to cause all of said documents, copies of which are attached to said Petition as Exhibits B to F, both inclusive, to be executed and delivered and certificates of Stock of the new corporation to be executed and issued to the bondholders who have voted against the trust, and Trust Certificates in the form set forth in Pages 2, 3, 4, and 5 of Exhibit B to be executed and issued to all other bondholders, and certificates of stock to be issued to the Trustees under said Trust Agreement and to or upon the order

of said Claridge Building Corporation, all in accordance with the provisions of the Plan of Reorganization.

Enter:

William H. Holly,

Judge.

Dated at Chicago,
July 22, 1935.

PETITIONER'S EXHIBIT NO. 7.

IN THE DISTRICT COURT OF THE UNITED STATES.

(Caption—56230)

PETITION.

Your Petitioner, George W. Rossetter, Jay C. McConnell and Sidney H. Kahn, not personally but as Claridge Apartments First Mortgage Bondholders' Committee, respectfully represent:

1. That heretofore on the 14th day of May, 1935, an order was entered herein confirming the plan of reorganization, which plan of reorganization provided, among other things, that Claridge Apartments Company, the new corporation organized pursuant thereto, should assume and agree to pay the unpaid reorganization expenses. The approximate amount of such unpaid reorganization expenses is \$13,500.00.

2. That the property described in the plan of reorganization to be conveyed to Claridge Apartments Company pursuant thereto, is subject to delinquent taxes, and approximate amount of which, including estimated taxes for the first half of 1934, is \$13,000.

3. That from the funds available and about to become available from the operation of the property approximately \$8,000 can be applied on account of the payment of the unpaid reorganization expenses and taxes, so that a sum of approximately \$18,500.00 is required for the payment of the balance of the unpaid reorganization expenses and taxes.

4. That a substantial saving can be effected in the interest and penalties due on delinquent taxes if immediate payment were made thereof.

5. That your Petitioners have procured a commitment

for a new first mortgage loan in the amount of \$18,500.00 from Brandy Brothers, the loan to bear interest at the rate of 5% per annum and to mature in 7½ years. There will be no required pre-payments, but Claridge Apartments Company, the new corporation, will have the right to retire all or any part of the loan on any interest payment date. In case of such pre-payment there will be a premium of 2% for the first two years, and thereafter there will be no premium in case of prepayment. The commission or discount to be charged for the making of the loan is to be 1½% plus \$75.00 to cover attorneys' fees of Brandy Brothers. Your Petitioners are of the opinion that the terms of such proposed loan are fair and reasonable, and recommend that the new corporation accept the loan on the terms outlined and that the net proceeds thereof be used for the payment of unpaid reorganization expenses and taxes, including the establishment of reserve for the payment of the first half of the 1934 taxes.

6. That Claridge Building Corporation, the Debtor herein, and Minnie H. Case have approved said loan and the disposition of the net proceeds thereof as aforesaid.

Wherefore, your Petitioners pray that an order be entered herein approving such new first mortgage loan, authorizing the new corporation to execute and deliver a first mortgage to evidence and secure same, and do all things necessary to consummate said loan with Brandy Brothers upon the terms and conditions hereinabove set forth, and to use the net proceeds thereof for the payment of the unpaid reorganization expenses and taxes, including the establishment of reserve for the payment of the first half of the 1934 taxes.

George W. Rossetter,

Jay C. McCord,

Sidney H. Kahn,

Constituting Claridge Apartments
First Mortgage Bondholder
Committee.

By: Jay C. McCord.

State of Illinois, }
County of Cook. } ss.

Jay C. McCord, being first duly sworn on oath, deposes and says that he is a member and the duly authorized agent of the above described committee; that he has read the above and foregoing Petition by him subscribed on behalf of said committee and knows the contents thereof, and that the same is true in substance and in fact.

Jay C. McCord.

Subscribed and sworn to before me this 25th day of July, A. D. 1935.

(Signed) Jennie T. Johnson,

(Seal)

Notary Public.

93 PETITIONER'S EXHIBIT NO. 8.

IN THE DISTRICT COURT OF THE UNITED STATES.

(Caption—56230)

ORDER.

This cause coming on to be heard on the Petition of the Claridge Apartments' First Mortgage Bondholders' Committee for the approval of a new first mortgage loan in the sum of \$18,500.00, an authorization to Claridge Apartments Company, the new corporation organized pursuant to the plan of reorganization, to execute and deliver a first mortgage to evidence and secure said loan and to do all things necessary to consummate said loan and to use the net proceeds thereof for the payment of unpaid reorganization expenses and taxes, including the establishment of a reserve for the payment of the first half of the 1934 taxes; and the Court having examined said Petition and Claridge Building Corporation, the debtor herein, and Minnie H. Case having approved said loan and the disposition of the new proceeds thereof as aforesaid, and being fully advised in the premises,

It is Ordered that the proposed new first mortgage loan for not to exceed \$18,500.00 upon the terms and provisions set forth in the Petition of said Claridge Apartments' First Mortgage Bondholders' Committee this day filed herein be, and the same is, approved.

It is further ordered that Claridge Apartments Company is hereby authorized to execute and deliver a first mortgage to evidence and secure said loan and do all things necessary to consummate said loan with Brandy Brothers, upon the terms and conditions set forth in said Petition, and to use the net proceeds of said loan for the payment of unpaid reorganization expenses and taxes, including the establishment of a reserve for the payment of the first half of the 1934 taxes.

Enter:

William Holly,

Judge.

Order entered July 26, 1935.

PETITIONER'S EXHIBIT NO. 9.

IN THE DISTRICT COURT OF THE UNITED STATES.

(Caption—56230)

REPORT.

Your Petitioners, George W. Rossette, Jay C. McGord and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, Claridge Building Corporation, the Debtor herein, and Minnie H. Case, pursuant to decrees and orders heretofore entered herein, submit the following report of acts and things done and performed by them in the execution and confirmation of the Plan of Reorganization, as amended, heretofore approved and confirmed herein and the documents executed in connection therewith:

1. Your Petitioners have caused to be organized a new corporation known as Claridge Apartments Company, the certificate of incorporation of which has been heretofore approved, and have caused to be executed and delivered the following documents (the form of each of which documents has heretofore been approved):

(a) Trust Agreement (including form of Trust Certificate);

(b) Management contract between the new corporation and Minnie H. Case;

(c) Surrender Agreement between Melvin L. Straus, as Trustee, and the new Corporation surrendering posses-

sion of the property described in the Plan of Reorganization as amended from said Melvin L. Straus, as Trustee, to the new corporation:

(d) Indemnification Agreement between the new corporation and Melvin L. Straus, as Trustee.

(e) Indemnification Agreement between the new corporation and Claridge Apartments First Mortgage Bondholders' Committee.

2. Claridge Building Corporation have executed, delivered and Recorded quit-claim deeds conveying their interest in the property described in the Plan of Reorganization as amended to the new corporation and Minnie H. Case has executed and delivered a bill of sale conveying her personal property containing in said property to the new corporation.

3. Melvin L. Straus, as Trustee, has filed his Final Report and account herein and has surrendered possession of said property to the new corporation and has or is about to apply the balance of the moneys in his possession derived from the operations of said property on account of the said property, and has delivered to the new corporation the books and records necessary to carry on the management and operation of said property. The stock and trust certificates to be issued pursuant to the Plan of Reorganization as amended and decrees and order heretofore entered herein have been prepared and are about to be issued, in accordance with the Provisions of said Plan of Reorganization as amended and decrees and orders heretofore entered herein.

4. That pursuant to the provisions of the Plan of Reorganization as amended and the Trust Agreement, the persons entitled to receive trust certificates have been notified that at a meeting of the shareholders of the new corporation to be held on September 8, 1925, a vote will be taken on the proposed mortgage in the amount not to exceed \$18,500, the terms and provisions of which have heretofore been approved by the Court and that unless one-third or more of those entitled to receive trust certificate advise the Trustees under the Trust Agreement in writing of their objection to and dissent from such proposed mortgage at or prior to said meeting, said Trustees intend to vote in favor of said mortgage. Upon the approval of such proposed mortgage at said Stockholders' meeting, your Petitioners will proceed to cause the execution and delivery of said mortgage.

96 Wherefore Your Petitioners pray that an order may be entered herein, finding that your Petitioners have done and performed all acts and things and executed and delivered all documents required to be done, performed, executed and delivered by them in the execution and confirmation of said Plan of Reorganization as amended, and the decrees and orders heretofore entered herein, and approving and confirming this report.

George W. Rossetter,

Jay C. McCord,

Sidney H. Kahn,

Not personally but as the Claridge Apartments First Mortgage Bondholders' Committee.

By George W. Rossetter,

Claridge Building Corporation,

by George B. Sleigh,

its duly authorized agent

Minnie H. Case,

by George B. Sleigh,

her duly authorized agent.

State of Illinois }
County of Cook } ss:

George W. Rossetter, being first duly sworn, on oath deposes and says he is a member and the duly authorized agent of the Claridge Apartments First Mortgage Bondholders' Committee, the petitioner herein above named; that he has read the above and foregoing Report by him subscribed on behalf of said committee and knows the contents thereof; and that the same is true in substance and in fact.

George W. Rossetter,

Subscribed and Sworn to before me this 12th day of August, 1935.

(Seal)

Natalie H. Lieber,

Notary Public.

97 State of Illinois }
County of Cook } ss.

George B. Sleigh, being first duly sworn on oath, deposes and says that he is the duly authorized agent of Claridge Building Corporation and Minnie H. Case, Petitioners hereinabove named; that he has read the above and foregoing report by him subscribed on behalf of said Claridge Building Corporation and Minnie H. Case and knows the contents thereof; that the same is true in substance and in fact.

George B. Sleigh.

Subscribed and Sworn to before me this 12th day of August, A. D. 1935.

Marion J. Weller,
Notary Public.

(Seal)

98 PETITIONER'S EXHIBIT NO. 10.

IN THE DISTRICT COURT OF THE UNITED STATES.

(Caption—56230)

ORDER.

This cause coming on to be heard on the Report of George W. Rossetter, Jay C. McCord, and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee; Claridge Building Corporation, the debtor herein, and Minnie H. Case, of the Acts and things done and performed by them in the execution and confirmation of the Plan of Reorganization as amended heretofore approved and confirmed herein and the documents executed in connection therewith, this day filed herein pursuant to decrees and orders heretofore entered herein, and the Court having examined said Report, and having heard the statements of counsel and being fully advised in the premises, Doth Find:

That said George Rossetter, Jay C. McCord and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, Claridge Building Corporation, the Debtor herein, and Minnie H. Case have done and performed all acts and things and executed

and delivered all documents required to be done and performed, executed and delivered by them, in the execution and confirmation of said Plan of Reorganization as amended and the decrees and orders heretofore entered herein.

It is therefore ordered that said Report of George W. Rossetter, Jay C. McCord and Sidney H. Kahn, not personally but as the Claridge Apartments First Mortgage Bondholders' Committee, Claridge Building Corporation, the Debtor herein, and Minnie H. Case this day filed herein, be and the same is hereby approved and confirmed.

Enter:

Philip L. Sullivan,
Judge.

Dated at Chicago,
August 13, 1935.

99 PETITIONER'S EXHIBIT NO. 12.

Walter Hamilton
Attorney and Counselor at Law
29 South LaSalle Street
Chicago, Illinois

Franklin 4849

February 11, 1942.

Mr. D. Altman of Internal Revenue Dept.
1300 Board of Trade Building,
Chicago, Illinois

Claridge Apartments Co. vs. Commission
of Internal Revenue

Dear Mr. Altman:

You will note in the above case that under the plan of Reorganization Bondholders of Claridge Building Corporation had an option to take immediately stock for their bonds in Claridge Apartments Company, the transferee of the property or trust certificates with three trustees holding title to the stock.

Pursuant to this plan the following stock was issued. The first day of issuance of any stock was September 5, 1935.

Certificate Number	Name of Shareholder	Date of Issuance	No. of Shares
1	Walter F. Babin, (bondholder)	9 5 35	10
2	Ida Beckman	" "	30
3	Kathryn Bellers	" "	20
4	Bertha Berggren	" "	5
5	Henry Brill	" "	5
7	Citizens Trust & Savings Bank Administrator,	" "	5
8	John D. Cole	" "	5
9	Mrs. Anna Dickson	" "	10
10	Fletcher Trust Co.	" "	1
11	James Ernest Fox	" "	10
12	Thomas M. George	" "	5
13	Harry P. Hoby	" "	5
14	Rev. Theodore H. Hoefer	" "	10
15	Miss Rita Jackson	" "	5
16	Percy O. Jones	" "	5
17	Roy Herschel Kopp	" "	5
18	Paul Kurz	" "	10
19	Edward B. Long	" "	30
20	Mrs. Mary B. Barkley	" "	10
21	Miss Sarah B. Mauger	" "	10
22	Alfred Freudenthal	" "	5
23	William Evan Powell	" "	10
24	Mrs. Marguerite C. Ross	" "	5
25	Meyer Victor	" "	12
26	George Washington Whipple	" "	5
27	Herbert C. Young	" "	12
28	Charles F. Henry (nominee of shareholder)	" "	8
30	George W. Rosseter et al. (Trustee for Bondholders) (Trustees)	" "	2492
32	Minnie H. Case (Shareholder)	" "	50
33	" " "	" "	50
34	" " "	" "	50
35	" " "	" "	50
36	" " "	" "	50
37	" " "	" "	50

Total 3050

Total not presented and not issued at once 28

Very truly yours,

Form 1120
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
Author's name:

Not to be filed with this return
CORPORATION INCOME AND EXCESS-PROFITS TAX RETURN
For Calendar Year 1935

Page 1 of Return
281
SEVEN
SEVEN
1-11111111

For Fiscal Year begin 1935 and ended 1935

PRINT PLAINLY CORPORATION NAME AND BUSINESS ADDRESS
CLERIDGE APARTMENTS COMPANY
ROOM 840 - 310 SOUTH MICHIGAN AVENUE
CHICAGO, ILL. 60605

We warrant, under penalty of perjury, that the information furnished on this return is true and correct to the best of our knowledge and belief.

Date of Incorporation **MAY 28, 1935**

Under the laws of what State or Country **ILLINOIS**

Class of stock: Common, Preferred, etc.

Is the Corporation a Subsidiary of another Corporation? **NO**
If so, name of parent corporation: **CLERIDGE APARTMENTS COMPANY**
Is the Corporation a Foreign Corporation? **NO**
If so, name of foreign corporation: **CLERIDGE APARTMENTS COMPANY**
Is the Corporation a Personal Holding Company? **NO**
If so, name of personal holding company: **CLERIDGE APARTMENTS COMPANY**

ATTACH SCHEDULES HERE

GROSS INCOME

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100
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1923-1924

For the Taxable Year

Assets	Amount	Total	Amount	Total
ASSETS				
1. Cash	8 604 17		7 299 37	
(a) Demand deposits, including checks				
(b) Time deposits, including certificates of deposit		8 604 17		7 299 37
(c) All other cash				
2. Notes receivable	1 162 70		1 162 70	
3. Accounts receivable	5 925 64		6 272 04	
(a) Less reserve for bad debts	5 982 47	105 83	7 032 47	402 27
4. Inventories				
(a) Raw materials				
(b) Work in process				
(c) Finished goods				
(d) Supplies				
5. Investments (investments)				
(a) Securities of U. S. Govt., Treasury or public utility, or stock of the United States or Canada				
(b) Securities issued under Federal Reserve Act, or other stock not so insured				
(c) Loans, notes, bonds, and other obligations of United States issued on or before September 1, 1917				
(d) Treasury notes, Treasury bills, and Treasury certificates of indebtedness				
(e) Loans, notes, bonds, and other obligations of United States, and Treasury bonds				
(f) Other securities of the United States other than those listed in (a) through (e)				
6. Other investments				
(a) Stocks of domestic corporations				
(b) Bonds of domestic corporations				
(c) Stocks and bonds of foreign corporations				
(d) All other investments or loans				
7. Deferred charges				
(a) Prepaid insurance	821 40		672 48	
(b) Prepaid taxes				
(c) All other	24 45	845 89	777 88	1 450 37
8. Capital assets				
(a) Buildings	162 000 00		162 000 00	
(b) Machinery and equipment				
(c) Furniture and fixtures	4 000 00		4 084 31	
(d) Delivery equipment				
(e) Other depreciable assets				
(f) Total of Lines (a) to (e)	166 000 00		166 084 31	
(g) Less reserve for depreciation		166 000 00	2 580 80	163 503 51
(h) Depreciable assets				
(i) Less reserve for depletion				
(j) Land		80 000 00		80 000 00
9. Patents				
10. Good will				
11. Other assets (describe fully)				
RESERVATIONS TO CANADA				
REPAIRS 1923	1 000 00			
		1 000 00		
TOTAL ASSETS		226 555 93		222 655 88
LIABILITIES				
12. Notes payable (less than 1 year)				
13. Accounts payable		2 021 32		1 721 34
14. Bonds and notes (not secured by mortgage)				
15. Mortgages (including bonds and notes so secured)				18 500 00
16. Accrued expenses				
(a) Interest			288 62	
(b) Taxes	17 273 63		5 707 56	
(c) All other		17 273 63		5 990 17
17. CAPITAL DELIVERED TO THE UNITED STATES (including interest on bonds)	188 266 22		200 98	
18. ORGANIZATION EXPENSES	18 300 69			
19. PREPAID RENTS	694 07	206 260 98	513 89	714 87
20. Capital stock				
(a) Preferred stock (less stock in treasury)				
(b) Common stock (less stock in treasury)	1 000 00	1 000 00	31 580 00	31 580 00
21. Surplus			184 149 50	
22. Undivided profits				64 149 50
TOTAL LIABILITIES		226 555 93		222 655 88

SCHEDULE L—RECONCILIATION OF NET INCOME AND ANALYSIS OF CHANGES IN SURPLUS

Net income subject to taxation (Line 30, page 1 of return)

+ 425

1. Deductions and adjustments

- (a) Depreciation, depletion, and amortization.
(b) Expenses that produce losses paid to the United States and work later paid to the Government or deemed a payment if earned as a credit in whole or in part in Item 20, page 1 of the return.
(c) Federal estate paid on tax-free assets.
(d) Federal income tax liability for the year, less the value of the property used for it.
(e) Payments and disbursements, or liabilities treated as increases on the books.
(f) Excesses that increase.
(g) Excesses paid on the life of any other or on property where the corporation is directly or indirectly a beneficiary.
(h) Excesses on subsidiaries transferred or assumed in purchase of every enterprise (other than subsidiaries of the United States) under the Statute of 1937, and originally contributed for by the taxpayer, the amount of which is wholly exempt from taxation.
(i) Additions to reserves or fund debts which are not included in Item 31, page 1 of return.
(j) Additions to reserves for contingencies, see the following:

Federal estate paid on tax-free assets

Federal income tax liability for the year, less the value of the property used for it

Payments and disbursements, or liabilities treated as increases on the books

Excesses that increase

Excesses paid on the life of any other or on property where the corporation is directly or indirectly a beneficiary

Excesses on subsidiaries transferred or assumed in purchase of every enterprise (other than subsidiaries of the United States) under the Statute of 1937, and originally contributed for by the taxpayer, the amount of which is wholly exempt from taxation

Additions to reserves or fund debts which are not included in Item 31, page 1 of return

Additions to reserves for contingencies, see the following:

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1. COST OF SALES (OTHER EXPENSES ARE AN INHERENT DETERMINING FACTOR)

2. COST OF OPERATIONS (WHEN INVENTORIES ARE NOT AN INHERENT DETERMINING FACTOR)

Salaries and wages
Other costsSalaries and wages
Other costs

SCHEDULE B - CAPITAL GAINS AND LOSSES (FROM SALES OR EXCHANGES ONLY) See Instructions 10

1. Description of Property	2. Date Acquired	3. Date Sold	4. Gross Sales Price (If known)	5. Cost	6. Market Value, If Not Sold, at Close of Year	7. Capital Gain or Loss (If Sold)	8. Description of Property	9. Date Acquired	10. Date Sold	11. Gross Sales Price (If known)	12. Cost	13. Market Value, If Not Sold, at Close of Year	14. Capital Gain or Loss (If Sold)
100 shares of IBM Corp. stock	1/15/34	1/15/34	100.00	100.00									

Gain or Loss (enter net amount on Item 10); capital losses are allowable only to the extent of \$2,000 per taxpayer spouse.

Ready (1) how property was acquired.

(2) whether at time of sale or exchange previously owned more than 50%

In value of your outstanding stock.

Every sale or exchange of stock should be reported in detail, including name and address of corporation, class of stock, number of shares, and date of sale.

No loss (which dividends, other non-cash dividends, stock rights, etc.)

Cost of property must be entered in column 5; if a loss is claimed in column 6.

SCHEDULE C - COMPENSATION OF OFFICERS See Instructions 15

1. Name and Address of Officer	2. Official Title	3. Total Income in Dollars	4. Amount of Compensation in Dollars
D. C. HARRIS	PRESIDENT, PARTY		100.00
E. HARRIS	V. PRESIDENT, PARTY		75.00
F. HARRIS	ASST. SECY.		1,736.95

Note: Schedule C-1 in duplicate also must be filed with this return if compensation in excess of \$1,000 was paid to any officer or employee.

SCHEDULE D - COST OF REPAIRS See Instructions 17

SCHEDULE E - TAXES PAID See Instructions 19

1. Amount (Enter on Item 17)	2. Description of Property	3. Amount (Enter on Item 19)
153.81	PERSONAL PROPERTY TAX	100.47
	FRANCHISE TAX	74.51
	REAL ESTATE TAX	1,736.95

SCHEDULE F - EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC. See Instructions 20

1. Date of Property	2. Date Acquired	3. Cost	4. Description of Loss	5. Description of Insurance	6. Amount of Loss	7. Amount of Insurance	8. Amount of Deduction
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SCHEDULE G - DIVIDENDS See Instructions 21

SCHEDULE H - INCOME FROM DIVIDENDS See Instructions 22

1. Year	2. Name of Corporation	3. Dividend Received	4. Dividend Received
1934	CHICAGO MILWAUKEE		
1935			
1936			
1937			
1938			
1939			
1940			
1941			

SCHEDULE I - EXPLANATION OF DEDUCTION FOR DEPRECIATION See Instructions 23

1. Date of Property	2. Date Acquired	3. Cost or Basis	4. Description of Property	5. Description of Depreciation	6. Amount of Depreciation	7. Amount of Depreciation	8. Amount of Depreciation
1934	1924	424,000.00			139,253.71	285,365.48	33-1/3 21-1/3 12.738 28
1935	1935	4,000.00				4,000.00	3 yrs. 3 yrs. 55% 50%

THIS CORPORATION WAS ORGANIZED IN ACCORDANCE WITH A PLAN OF REORGANIZATION APPROVED BY THE DISTRICT COURT OF THE U.S., NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION UNDER SECTION 77-B OF THE BANKRUPTCY ACT AS AMENDED. THIS CORPORATION IS BEING TRUSTEED AS A SUCCESSOR ORGANIZATION UNDER SECTION 77-B OF THE BANKRUPTCY ACT OF 1934 AND SECTION 77-B OF THE BANKRUPTCY ACT OF 1934.

The undersigned, president (or other principal officer and treasurer for assistant treasurer or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself depose and say that the return, including the accompanying schedule and statements in Part I, has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith for the taxable year stated pursuant to the Revenue Act of 1934 and the Regulations issued thereunder.

Return to be submitted before the 15th day of

1941

RETURN TO BE SUBMITTED BEFORE THE 15TH DAY OF 1941

My Commission Expires August 17, 1939

AFFIDAVIT See Instructions 24

I, the undersigned (or officer) that I have prepared this return (or the person named herein) and I depose and say that the accompanying schedule and statements in Part I are a true, correct, and complete statement of all the information respecting the taxable year for which this return has been prepared of which I am hereunto sworn.

Return to be submitted before the 15th day of

1941

RETURN TO BE SUBMITTED BEFORE THE 15TH DAY OF 1941

My Commission Expires August 17, 1939

Signature of person preparing return

Name of person preparing return

104

Schedule 1

1935

Claridge Apartments Company

Other Expenses

• Period August 1, 1935 to December 31, 1935

Janitor's Salary	\$ 750.00
Houseman's Salary (Compensation)	400.00
Houseman's Salary (Apartment)	75.00
Housekeeper's & Maid's Salary (Compensation)	398.43
Housekeeper's & Maid's Salary (Apartment)	137.50
Watchman's Salary (Apartment)	160.00
Manager's Salary (Apartment)	200.00
Laundry	194.04
Cleaning Curtains	38.75
Exterminating	35.00
General Supplies	265.00
Miscellaneous (Building Service)	26.75
Electricity	1,067.14
Gas	315.10
Water	155.33
Electrical Supplies	83.42
Fuel	1,023.50
Ash Removal	23.59
Miscellaneous Heat, Light & Power	22.50
Painting & Decorating	456.57
Shades	16.45
Accounting & Auditing	175.00
Legal & Collection	147.25
Advertising	103.45
Telephone	68.92
Agent's Commission	825.51
Trustee's Fees	163.59
Office Salaries	97.50
Mailing Expense, Stockholders, etc.	11.70
Miscellaneous (General)	215.80
Stationery & Supplies	187.45
Insurance	438.23
Mortgage Expense	14.30

\$8,292.77

105

Form 707

Duplicate

First

III

Treasury Department
Internal Revenue Service
Revised May 1935

(Collection district)
Assessment List, Form 23A
Aug 1935
(Month) (Year)
53981

To be stamped by col-
lector, showing dis-
trict and date received

(Page) (Line)
Examined by:

1935 Return

of

Capital Stock Tax

For year ending June 30, 1935.

Domestic Corporations

(See 701, Revenue Act of 1934, 73d Congress, Public
No. 216)

This return must be filed, in duplicate, with the Collector
of Internal Revenue for your district on or before July 31,
1935; and the tax must be paid on or before that date.

(Stamps) Delinquent D C R Dates Aug 10 1936
Received Jul 1936 Collector of Internal Revenue 1st
Dist. Ill. Received Payment Aug 14 1936 Carter H
Harrison Collector of Internal Revenue 1st Dist. Ill.
Carter H. Harrison Tax Division Audit Section Oct
1936 Audited by HAP

1. Name (Print name of corporation, joint stock com-
pany, or association) Claridge Apartments Cor-
poration.
2. Address (The address must be that of the principal
place of business. Give "Street and number",
"City or town", and "State") Room 840 311 S
Michigan Ave., Chicago, Ill.
3. Name of parent company, if any
(District filed)
4. Name of subsidiary, if any (Or attach list and state
number of shares held; also districts where filed)

(District filed

No. shares held

).

5. Nature of business in detail. Owning and Operating an Apartment Building.
6. Incorporated or organized in State of Illinois. Month May Year 1935.
7. Was a capital-stock tax return filed for the preceding taxable year ended June 30, 1934? No. If filed under a different name, state the name (District filed).
8. Date of last income-tax taxable year ended on or prior to June 30, 1935, or, if newly organized corporation having no income tax taxable year ended on or prior to June 30, 1935, date of organization May 28, 1935 (Date of Incorp.).

Corporations making an original declaration of value upon this return must enter the amount of such declared value in item 9. This block is not to be used by a corporation which established its original declared value by the first return for the year ended June 30, 1934.

9. Original Declared Value of Entire Capital Stock as of \$40,000.00

Corporations which have established their original declared value by the return for the year ended June 30, 1934, must adjust such declared value as provided for in Schedule I on page 2 of this return and then enter the amount of the adjusted declared value in Item 10.

10. Adjusted Declared Value of Entire Capital Stock as of

Corporations claiming exemption from the tax must indicate the basis of the claim by a check in the appropriate block under item 11 and must furnish the information specifically requested thereunder.

11. Corporation enumerated in section 191, Revenue Act of 1934. (1) State under which subsection exempt. (2) Furnish information requested under instructions 12.
- Insurance company subject to tax under section 201, 204, or 207, Revenue Act of 1934. State which section

- ☐ Corporation not doing business. (1) Furnish information requested under instructions 14. (2) See instructions 15 with respect to making or adjusting a declaration of value for capital stock.

Computation of Tax	For Use of Taxpayer	For Use of De- partment
12. Original or adjusted declared value as entered in item 9 or 10	\$40,000.00	
13. Tax at rate of \$1 for each full \$1,000 in item 12 (omit cents)	40 x	x
14. Penalty of 25 percent for delinquency in filing return	10	
15. Interest 1% to Sept. 1, 1935. 1% per Month thereafter	2.60	
16. Total tax, penalty, and interest	52.60	

I, the undersigned (Name of president, vice president, or other principal officer) M. C. Kuehn, (Title) President and (Name of treasurer, assistant treasurer, or chief accounting officer) (Title) _____ of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1934 and the Regulations issued thereunder.

M. C. Kuehn,
(Corporate Seal) President.

Sworn to and subscribed before me this 30th day of July, 1936.

Elsa Nordson,
(Notarial Seal) Notary Public.

My Commission Expires August 17, 1939.

106

TREASURY DEPARTMENT

Internal Revenue Service
Chicago, Ill.

(Stamps) Received Subsection D Feb 19 1941 Files
Section Records Division Feb. 17, 1941.

Office of

Internal Revenue Agent in Charge

Chicago Division

105 West Adams Street

ITC:JCR

Commissioner of Internal Revenue,
Washington, D. C.

Attention: IT:Rec:F:D-EBL

In re: Claridge Apartments Company,

310 South Michigan Avenue,

Chicago, Illinois.

Year: 1935

Reference is made to your letter dated February 11, 1941, requesting that the return of the above-named taxpayer for the year 1935 be forwarded for photostat. Accordingly, the return, Form 1120, Serial No. 864084 is enclosed herewith. It will be appreciated if said return is transmitted to this office after it has served its purpose.

E. C. Wright,

Internal Revenue Agent in Charge.

pmr

107

Duplicate

Form 872

Treasury Department

Internal Revenue Service

(Revised Sept. 1939)

Consent Fixing Period of Limitation Upon Assessment of
Income and Profits Tax

(Stamp). Received Mar 27 1940 Int. Rev. Agent in
Charge Chicago, Illinois.

March 26, 1940.

In pursuance of the provisions of existing Internal Revenue Laws Claridge Apartments Company, a taxpayer (or

taxpayers) of Chicago, Illinois, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year (or years) ended December 31, 1935, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1941, except that, if a notice of a deficiency in tax is sent to said taxpayer (or taxpayer) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter.

Claridge Apartments Company,

(Seal)

By Walter Hamilton,

Taxpayer

Secretary

Guy T. Helvering,

Commissioner of Internal Revenue.

By E. C. W. Mar. 28, 1940.

(Date)

1. This consent may be executed by the taxpayer's attorney or agent provided such action is specifically authorized by a power of attorney which if not previously filed must accompany the consent.

If executed with respect to a year for which a Joint Return of A Husband And Wife was filed, this consent must be signed by both spouses unless the one spouse acting under a power of attorney, signs as agent for the other.

2. If this consent is executed on behalf of a corporation it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation. In addition to which the seal of the corporation must be affixed. Where the corporation has no seal the consent must be accompanied by a certified copy of the resolutions passed by the board of directors giving the officer authority to sign the consent.

108 Memorandum Justifying the Acceptance of Consent Extending the Statute of Limitations

Chicago, Illinois,
March 28, 1939.

Internal Revenue Agent in Charge,
Chicago, Illinois.

In re: Claridge Apartments Company,
29 S. La Salle St., Room 840,
Chicago, Illinois.

Taxable Year Ended December 31, 1935.

Attached is a signed consent, Form 872, extending the statute of limitations until June 30, 1941, executed by the above-named taxpayer for the calendar year ended December 31, 1935.

A completed income and excess profits tax return, Form 1120, was filed on March 16, 1936, in the 1st District of Illinois at Chicago, Illinois, which is on file in this Division. The corporation is still active.

The consent is accepted in order to give the taxpayer an opportunity for a hearing before the local office of the Chicago Division of the Technical Staff.

Carl C. Thomas,
Carl C. Thomas,
Conferree.

CCT:SLB

109

Duplicate

Form 872,
Treasury Department
Internal Revenue Service
(Revised Nov. 1938)
ET:R: D 5
FKW

Consent Fixing Period of Limitation Upon Assessment of
Income and Profits Tax

(Stamps) Received Mar 2 1939 Audit Division D.
Original to Central Waiver File Mar 8 1939.

February 28, 1939

In pursuance of the provisions of existing Internal Revenue Laws Claridge Apartments Company, a taxpayer

(or taxpayers) of Chicago, Illinois, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year (or years) ended December 31, 1935, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1940, except that, if a notice of deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter.

Claridge Apartments Company,

Taxpayer.

By Walter Hamilton,

Secretary.

(Seal)

Guy T. Helvering,

Commissioner of Internal Revenue.

By E. A. C. 3 8 39.

(Date)

FKW EDS-3

1. This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a Joint Return of A Husband And Wife was filed, this consent must be signed by both spouses unless the one spouse, acting under a power of attorney, signs as agent for the other.

2. If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolutions passed by the board of directors giving the officer authority to sign the consent.

Page 2 of Return

Date of Incorporation **MAY 20, 1938**

Under the laws of what State or country?

ILLINOIS

The corporation's books are in care of **SECURITIES SERVICE CORP.**

310 S. MICHIGAN AVE.,

CHICAGO, ILL.

Kind of business (in detail) **OFFICES & OPERATIONS IN APARTMENT BUILDINGS**Is this a consolidated return for a corporation? **NO**

If how many corporations?

If this is not a consolidated income tax return of railroad corporations, did the corporation at any time during the taxable year own

20 percent or more of the voting stock of another corporation or corporations? **NO**

If so, attach separate schedule showing

with respect to each corporation: (1) name and address of corporation, (2) percentage of stock owned, (3) date stock was acquired, and (4) the collector's office in which the corporation's income tax return for the taxable year was filed.

Is the corporation a personal holding company within the meaning of Section 351 of the Revenue Act of 1936? **NO**

an additional return on Form 1120H must be filed.)

Did the corporation make a return of information on Forms 1096 and 1099 for Instruction in Form 1040 for calendar year 1938? **NO**

NET INCOME COMPUTATION

GROSS INCOME

1. Gross Sales (where inventories are an income-determining factor): \$
2. Less Cost of Goods Sold:
- (a) Inventory at beginning of year
- (b) Material or merchandise bought for manufacture or sale
- (c) Manufacturing costs (from Schedule A, Column 1):
- (1) Salaries and wages, \$
- (2) Other costs, \$
- (d) Total of lines (a), (b), and (c)
- (e) Less inventory at end of year
3. Gross Profit from Sales (Item 1 minus Item 2)
4. Gross Receipts (where inventories are not an income-determining factor): \$ **43,607.28**
5. Less cost of operations (from Schedule A, Column 2):
- (a) Salaries and wages, \$ **192.93**
- (b) Other costs, \$ **17,981.32**
- Total \$ **23,174.25**
6. Gross Profit where inventories are not an income-determining factor (Item 4 minus Item 5) **20,433.03**
7. Interest on Loans, Notes, Mortgages, Bonds, Bank Deposits, etc.
8. Interest on Government obligations, etc. (from Schedule M, Lines 4, 5, 6, and 7)
9. Rents
10. Royalties
11. Capital Gain or Loss (if an Schedule B, if loss, enter with minus sign)

12. Dividends—Stock of:

- (a) Domestic Corporations subject to taxation under Title I of Revenue Act of 1936
- (b) Domestic Corporations not subject to taxation under Title I of Revenue Act of 1936
- (c) Foreign Corporations

13. Other Income (State nature of income) (Use separate schedule, if necessary)

14. Total Income in Items 3 and 6 to 13 inclusive **20,433.03**

DEDUCTIONS

15. Compensation of Officers (from Schedule C)
16. Rent on Business Property
17. Repairs (from Schedule E): (a) Salaries and Wages, \$
- (b) Other Costs, \$
- Total \$ **1,336.02**
18. Bad Debts (from Schedule F), also bonds determined to be worthless during the taxable year (attach on separate sheet) **375.00**
19. Interest Paid (from Schedule G) **925.00**
20. Taxes Paid (from Schedule H) (Do not include Federal Income Taxes Reported in Item 28 below) **4,817.33**
21. Contributions or Gifts (from Schedule I)
22. Losses by Fire, Storm, etc. (from Schedule J)
23. Depreciation (resulting from exhaustion, wear, and tear in case of depreciable assets) (from Schedule K) **14,071.48**
24. Depletion of Mines, Oil, and Gas Wells, Timber, etc. (Attach explanation on separate sheet)
25. Other Deductions Authorized by Law (explain below or on separate sheet):
- (a) Salaries and wages (Not included in Items 2, 3, 15 or 17 above)
- (b) Bonds determined to be worthless during the taxable year
- (c)

26. Total Deductions in Items 15 to 25 inclusive

21,524.43

27. Net Income for Federal Income Tax Computation (Item 14 minus Item 26)

1,091.60

28. Less Federal Income Tax (from Form 1120)

1,091.60

29. Net Income for Federal Income Tax Computation (Item 27 minus Item 28)

SCHEDULE A (See Instructions 2 and 5)

1. COST OF SALES (WHICH IS NECESSARY) IS AN INCOME-DETERMINING FACTOR

... OF THE ABOVE-REPRODUCED DOCUMENTS ARE NOT AN INCOME DETERMINING FACTOR

Business and wages
Other cities.

Area and weight
(mm^2 and mg)

SEE SCHEDULE 1

SCHEDULE D—CAPITAL GAINS AND LOSSES (FROM SALES OR EXCHANGES ONLY) (See instructions.)

[illegible]

State or Local (enter net amount on Form 11, page 3; if net amount is a loss, enter that amount or \$2,000, whichever is less)

Note (1): No property was acquired.

(2) whether at time of sale or exchange purchaser owned more than 50%

Is value of your outstanding stock

Every sale or exchange of stock should be reported in detail, including name and address of corporation; class of stock; number of shares; capital charge; selling price (less dividends, other distributable dividends, stock rights, etc.)

Cost of property must be entered in column 8 if a loss is claimed in column 9

SCHEDULE C—COMPENSATION OF OFFICERS (See Instruction 18)

BIRMINGHAM CONSERVATION OF WATER		22. DED. OF FINE (OWNED)		3. WATER-USE	
1. NAME AND ADDRESS OF OWNER		2. DEDUCTIBLE	3. TAX DEDUCTIBLE	4. FINE	5. FINE
Mr. C. H. HARRIS	1000 1/2	PAID - TAXES	PAID		NO
Mr. HARRIS	1000 1/2	PAID - SUBV.	5		
Mr. HARRIS	1000 1/2	AUDY. SUBV.			

Form: Schedule O-1 (IN DUPLICATE) also must be filed with this return if compensation in excess of \$15,000 was paid for any officer or employee.

SCHEDULE D—INCOME FROM DIVIDENDS (See instruction 1.)

Indicate below all dividends received during the year, stating the amount and the name and address of the corporation which declared the dividend.

SCHEDULE B-COST OF REPAIRS (See Instruction 17)

1. APPROX (Date of Exam) 17 June 68

2. 1 536 02

SCHEDULE F-BAD DENTS (See Instruction 18)

1. Year	2. New Issues	3. Issues Reaff. Issues	4. Rep. Issues
1982	5	5	5
1983			0
1984			
1985	8/1 TO 12/31	17 461 78	None
1986		43 820 86	378 00

SCHEDULE C—INTEREST PAID (See Instructions 19)

1. Agency (Name and location) page 1

928 00

SCHEDULE H—TAXES PAID (See instruction 20)

1. Name of Tax	2. To Whom Paid	3. Amount (Paid or Due)
REAL ESTATE	ADDRESS	14 399 0
FEDERAL CAPITAL STOCK TAX	SECRETARY OF STATE OF ILL.	238 0
FRANCHISE TAX	COOK COUNTY COLLECTOR	95 1
FEDERAL PROPERTY	ADDRESS	14 9
INSURANCE PREMIUMS - 1936		73 2
		94 878 3

SCHEDULE 1 CONTRIBUTIONS OR GIFTS (See Instruction 2)

Name and address of contributor

42 (b)(1)

Totals (Enter on Item 21, page 2, subject to 5% limitation per Instruction 2)

SCHEDULE 2-EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC. (See Instruction 2)

1. Name of Property	2. Date Acquired	3. No.	4. Property was destroyed	5. Insurance allowed for allowable loss	6. Insurance and Salvage Value	7. Depreciable loss (Enter on Item 21, page 2)

State how property was acquired

SCHEDULE 3-EXPLANATION OF DEDUCTION FOR DEPRECIATION (See Instruction 2)

1. Name of Property	2. Date Acquired	3. Cost or Market Value of Property at Time of Depreciation	4. Annual First Year Depreciation	5. Depreciation Allowed for Allowable Loss	6. Remaining Cost or Value at End of Year	7. Loss from Depreciation	8. Depreciable Loss (Enter on Item 21, page 2)
BRICK	1924	424 009 19		181 991 99	272 617 20	53-1/3	22-1/3 12 730 29
FURNITURE	1925	2 907 89		555 50	3 362 09	37-1/2	1 333 80 X

THIS CORPORATION WAS ORGANIZED IN ACCORDANCE WITH A PLAN OF REORGANIZATION APPROVED BY THE DISTRICT COURT OF THE U. S. NORTHERN DISTRICT OF ILL. EASTERN DIVISION UNDER SECTION 775 OF THE BANKRUPTCY ACT AS AMENDED. THIS CORPORATION IS BEING TREATED AS A CORPORATE REORGANIZATION UNDER SECTION 112 OF THE REVENUE ACT OF 1934 AND SAID LOSS FOR DEPRECIATION IS THAT OF THE PREORGANIZATION CORPORATION.

NATURE OF BUSINESS

1. Check the block in column 1 below the business division in which the corporation's main business is conducted:
- MANUFACTURING**
- ☐ Food and kindred products
 - ☐ Textile and kindred products
 - ☐ Lumber and kindred products
 - ☐ Chemical and allied products
 - ☐ Petroleum and allied products
 - ☐ Rubber, leather, and other products
 - ☐ Stone, clay, and other products
 - ☐ Glass and other products
 - ☐ Paper and other products
 - ☐ Printing and other products
 - ☐ Metal and other products
 - ☐ Machinery and other products
 - ☐ Electrical and other products
 - ☐ Chemical and allied products
 - ☐ Petroleum and allied products
 - ☐ Rubber, leather, and other products
 - ☐ Stone, clay, and other products
 - ☐ Glass and other products
 - ☐ Paper and other products
 - ☐ Printing and other products
 - ☐ Metal and other products
 - ☐ Machinery and other products
 - ☐ Electrical and other products
- MANUFACTURING (Continued)**
- ☐ Other products and kindred products
 - ☐ Machinery and other products
 - ☐ Electrical and other products
 - ☐ Chemical and allied products
 - ☐ Petroleum and allied products
 - ☐ Rubber, leather, and other products
 - ☐ Stone, clay, and other products
 - ☐ Glass and other products
 - ☐ Paper and other products
 - ☐ Printing and other products
 - ☐ Metal and other products
 - ☐ Machinery and other products
 - ☐ Electrical and other products
- NON-MANUFACTURING**
- ☐ Real estate
 - ☐ Finance and insurance
 - ☐ Transportation
 - ☐ Communication
 - ☐ Public utility
 - ☐ Other

AFFILIATIONS WITH OTHER CORPORATIONS (See Instruction 2)

1. Is this a subsidiary corporation? **NO** If so, please give the name of the corporation in which the corporation is a subsidiary, which shall be filed in Item 21, page 2, of this return.

2. If the corporation is a subsidiary of another corporation, give the name and address of the corporation in which the corporation is a subsidiary, which shall be filed in Item 21, page 2, of this return.

3. If the corporation is a subsidiary of another corporation, give the name and address of the corporation in which the corporation is a subsidiary, which shall be filed in Item 21, page 2, of this return.

PRIOR YEAR'S RETURN

Did the corporation file a return under the same name for the preceding taxable year? **YES**

If so, the corporation is not required to file a return for the preceding taxable year, but it must file a return for the current taxable year.

CLARKE BUILDING CORPORATION, AUG. 1, 1938

BASE OF RETURN

1. Is the return made on the basis of cash receipts and disbursements? **NO**

2. If not, describe fully what other basis or method was used in computing the return.

VALUATION OF INVENTORIES

3. Have the inventories in the beginning and end of the taxable year been valued at cost, or at market, whichever is lower? If other basis was used, describe fully what was used and the basis for the valuation.

NO

PREPARATION OF RETURN (See "Signatures and Attachments," page 2)

4. The tax preparer or preparer of the return is required to sign the return and to attach a statement of the preparer's name, address, and occupation, and to sign the return and to attach a statement of the preparer's name, address, and occupation, and to sign the return and to attach a statement of the preparer's name, address, and occupation.

M. C. KENNEDY, Room 840, 310 S. MICHIGAN AVE
CHICAGO, ILL.

LIST OF ATTACHED SCHEDULES

5. Have you a list of all schedules accompanying this return, giving for each a brief title and the schedule number? The name and address of the corporation should be given in each separate schedule.

SCHEDULE 1 - OTHER CM 75

Assets	Liabilities	Total	Total
1. Cash.			
(a) Demand deposits, including checks		7 299 37	4 306 99
(b) Time deposits, including certificates of deposit			
(c) All other cash			
2. Notes receivable.		1 162 76	1 162 76
3. Accounts receivable.		6 273 04	6 060 49
(a) Less reserve for bad debts		7 032 47	377 46
4. Inventories.			
(a) Raw materials			
(b) Work in process			
(c) Finished goods			
(d) Supplies			
5. Investments (securities):			
(a) Obligations of a State, Territory, or Federal subdivision thereof, or the District of Columbia, or United States possessions			
(b) Obligations issued under Federal Farm Loan Act, or under such Act as amended			
(c) Liberty 4½% Bonds and other obligations of United States issued on or before September 1, 1917			
(d) Treasury Notes, Treasury Bills, and Treasury Certificates of Indebtedness			
(e) Liberty 4½% and 4½% Bonds, United States Savings Bonds, and Treasury Bonds			
(f) Obligations of instrumentalities of the United States (other than obligations to be reported in line (b) above)			
6. Other investments:			
(a) Stocks of domestic corporations			
(b) Bonds of domestic corporations			
(c) Stocks and bonds of foreign corporations			
(d) All other investments or loans			
7. Deferred charges:			
(a) Prepaid insurance		672 46	1 588 13
(b) Prepaid taxes		777 89	4 102 89
(c) Other			
8. Capital assets:			
(a) Buildings		162 000 00	162 000 00
(b) Machinery and equipment			
(c) Furniture and fixtures		4 084 37	3 987 99
(d) Delivery equipment			
(e) Other depreciable assets			
(f) Total of Lines (a) to (e)		166 084 37	165 987 99
(g) Less reserves for depreciation		2 580 50	8 778 70
(h) Depreciable assets			157 129 99
(i) Less reserves for depletion			
(j) Land		50 000 00	50 000 00
9. Patents.			
10. Good will.			
11. Other assets (describe fully):			
12. Total Assets		222 655 88	215 916 92
LIABILITIES			
13. Notes payable (less than 1 year):			
14. Accounts payable		1 721 34	491 62
15. Bonds and notes (not secured by mortgage)		18 500 00	18 500 00
16. Mortgages (including bonds and notes so secured)			
17. Accrued expenses:			
(a) Interest		282 62	282 62
(b) Taxes		5 707 58	7 162 17
(c) All other			111 15
18. Other liabilities (describe fully):			
UNPAID REORGANIZATION EXP. PAYABLE STATE		200 98	678 75
		513 89	
19. Capital stock (long stock in treasury):		714 87	31 580 00
(a) Preferred stock (long stock in treasury)			
(b) Common stock (long stock in treasury)		31 580 00	31 580 00
20. Surplus		164 149 59	157 109 71
21. Undivided profits		164 149 59	157 109 71
22. Total Liabilities		222 655 88	215 916 92

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Schedule 1

Claridge Apartments Company

Other Costs—(Schedule A—Column 2)

Laundry	\$ 509.34
Cleaning Curtains	165.17
Exterminating	84.00
General Supplies	572.80
Electricity	3,271.33
Gas	937.32
Water	515.10
Electrical Supplies	187.70
Fuel	2,533.73
Ash Removal	112.37
Miscellaneous—Heat, Light & Power	6.00
Painting and Decorating	3,324.87
Shades and Shade Cleaning	73.09
Accounting and Auditing	873.72
Advertising	220.26
Telephone	155.06
Agent's Commission	2,133.07
Trustees' Fees	423.09
Depository Fees, Mailing Notices, Exp., etc.	480.15
Miscellaneous—General	183.98
Stationery and Supplies	41.50
Legal	186.74
Insurance	944.13
Mortgage Expense	46.80

\$17,981.32

117 Form 1120—Schedule N
 Treasury Department
 Internal Revenue Service

Analysis of Dividends Paid and Receipts and Expenditures
 on Account of Changes in Corporation's Obligations and
 Capital Stock.

For Calendar Year 1936

Or fiscal year begun ¹⁹³⁶ 1936, and ended
 1937.

(Date received)

This schedule, together with
 green copy marked "Dupli-
 cate" must be filed with and
 as part of the corporation in-
 come and excess-profits tax re-
 turn for the taxable year.

Print plainly corporation's name and business address—

Claridge Apartments Company
 (Name)

Room 840, 310 S. Michigan Avenue
 (Street and number)

Chicago Cook Illinois
 (Post office) (County) (State)

List below all dividends paid during the taxable year,
 stating in each case the character of the dividend, and
 entering the amounts in the proper columns respecting the
 taxable status of the dividends. If the total amount shown
 below differs from that reported in Schedule M, item 17,
 explain the difference at the end of this schedule. Divi-
 dends paid in treasury stock should be entered in item 20
 and not in items 5 through 8. It is essential that dividends
 in which the medium of payment is elected by the share-
 holders be carefully reported in item 9, and correspond-
 ingly excluded from items 1 through 8.

Respondent's Exhibit B.

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Item No.	Character of Dividend	Taxable Dividends (1)	Nontaxable Dividends (2)	Total (3)
1	Cash	\$11,234.70	\$3,385.80	\$14,620.50
2	Treasury stock			
3	Assets other than money or the corporation's own securities. (Explain character of each payment; use separate schedule if necessary.)			
4	Obligations of the corporation (bonds, notes, scrip, etc.)			
5	Common stock of the corporation to holders of preferred* stock			
6	Preferred* stock of the corporation to holders of preferred* stock			
7	Preferred* stock of the corporation to holders of common stock			
8	Common stock of the corporation to holders of common stock			
9	Optional—Medium of payment elected by the shareholders. (List below separately the amounts disbursed in each medium of payment): Cash Common stock Other (specify character)			
10	Total (items 1 to 9)	\$11,234.70	\$3,385.80	\$14,620.50
11	Dividends paid credit (item 29, page 1, of return)			
12	Dividend carry-over (item 10 minus item 11)	11,234.70		

* Preferred stock for this purpose should be considered as stock which is preferred as to either dividends or assets irrespective of formal designation.

CAPITAL STOCK TAX

For Year Ending June 30, 1938-

DOMESTIC CORPORATIONS

DOMESTIC COMPANIES

This return must be filed, in triplicate, with the Collector of Internal Revenue for your district on or before July 31, 1926, and the tax must be paid on or before that date.

To be stamped by collector, showing district and date received

Name **Cluridge Apartments Company**

2 Address Room 840 - 310 S. Michigan Ave. Chicago, Ill.

3. Name of parent company, if any:

4 Name of subsidiary, if any No shares held

4. Nature of business in detail: **Owning and Operating an Apartment Building**

3. Incorporated or organized in State of Illinois Month May

* Was a consolidated stock tax return filed for the preceding taxable year ended June 30, 1933? **Yes**

7. Was a capital-stre
state the nature

8. DECLARED VALUE OF ENTIRE CAPITAL STOCK

DECLARED VALUE OF ENTIRE CAPITAL STOCK

9. **EXEMPTIONS.**—The Act provides for an exemption from the tax only on the grounds indicated below. Corporations claiming exemption must (1) declare a value for the capital stock under item 8, (2) check the appropriate block under item 9 showing the basis for the claim, and (3) submit with the return a full statement of the evidence supporting the block.

Contribution exempt from income tax under section 101. Revenue Act of 1934 (State under which contribution was made) 101

(2) Foreign information required by instruction 4

Insurance company subject to tax under section 201, 204, or 202, Revenue 1034 State which section

Continuation and doing business. (1) Furnish information required by Section 6. (2) Declare value of capital stock in item 1.

Corporation not doing business
state

10. Declared value (must be identical figure entered in item 8)

11 Tax at rate of \$1.40 for each full \$1,000 in item 8

12. *Examine the delinquency in drug returns (see inst. 7)*

(3) Interest at 6 percent per annum beginning August 1, 1936

to Total ⁽²⁾ monthly and interest

15. State amounts of outstanding capital stock and surplus as of date of the close of income tax taxable year used in declaring value for capital stock. (If nonstock organization, so indicate and attach statement of net worth.)

Statement of Financial Position	Assets	Liabilities	Equity
Current assets	1,000,000	500,000	500,000
Property, plant, and equipment	2,000,000		2,000,000
Intangible assets	100,000		100,000
Other assets	100,000		100,000
Total assets	3,200,000	500,000	2,700,000
Current liabilities		200,000	
Long-term liabilities		300,000	
Equity			2,700,000
Common stock			1,000,000
Retained earnings			1,700,000
Total equity			2,700,000
Total liabilities and equity		500,000	2,700,000

I, the undersigned

Mr. C. E. Kuehn

President

and

I declare under penalty of perjury that the foregoing is a true and correct copy of the original return and all attachments thereto. I am a partner in the partnership and have not been removed from the partnership since the end of the partnership's last taxable year. I am not a partner in the partnership for the taxable year for which this return is made, being severally duly sworn, each for himself, deponent and says that this return, including any accompanying statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1938 and the Regulations issued thereunder.

Sworn to and subscribed before me this _____ day of _____, 19____.

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ITV014502

1997-1998

CORPORATE

City of Chicago, August 17, 1939

118 7 4

119

Chicago, Illinois
January 20, 1940

Internal Revenue Agent in Charge,
Chicago, Illinois.

In re: Claridge Apartments Company
#937—29 S. La Salle Street
Chicago, Illinois

Year Ended: December 31, 1936

Attached hereto is consent, Form 872, executed on behalf of the above named corporation, which extends the period during which income and profits tax for the year ended December 31, 1936 may be assessed, to June 30, 1941.

The taxpayer corporation, which is still in existence, has requested that the consent be accepted in order that there may be sufficient time within which to give its case thorough consideration.

The original return, which is in my possession, was filed on March 15, 1937.

For the reasons given by the taxpayer, it is recommended that the consent be accepted.

Reuben Agranowsky,
Internal Revenue Agent.

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Duplicate

Form 872

Treasury Department
Internal Revenue Service
(Revised Sept. 1939)

Consent Fixing Period of Limitation Upon Assessment of
Income and Profits Tax

(Stamp) Received Jan 24 1940 Int. Rev. Agent in
Charge Chicago, Illinois.

January 20, 1940.

In pursuance of the provisions of existing Internal Revenue Laws Claridge Apartments Company, a taxpayer (or taxpayers) of #937—29 S. La Salle St., Chicago, Illinois, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess profits, or war-

profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year (or years) ended December 31, 1936, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1941, except that, if a notice of a deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment, and for sixty days thereafter.

Claridge Apartments Company,

Taxpayer.

By: Walter Hamilton,

Secretary.

(Seal)

Guy T. Helvering,

Commissioner of Internal Revenue.

By F. J. H. Jan. 24, 1940.

(Date)

1. This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a Joint Return Of A Husband And Wife was filed, this consent must be signed by both spouses unless the one spouse, acting under a power of attorney, signs as agent for the other.

2. If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolutions passed by the board of directors, giving the officer authority to sign the consent.

1937

UNITED STATES

CORPORATION INCOME AND EXCESS-PROFITS TAX RETURN

1937

Treasury Department

(FORM 1120)

Internal Revenue Service

For Calendar Year 1937 or Fiscal Year

beginning 1937, and ended 1938

PRINT PLAINLY CORPORATOR'S NAME AND ADDRESS

File
No.

850894

District

CHICAGO

(Number & Name)

REVIEWED

QUALITY DIVISION

BY J E MATTHEWS

DATE MAY 20 1937

CLARIDGE APARTMENTS COMPANY

(Name)

Room #937 - 29 S. La Salle Street

(Street and number)

Chicago

(Post office)

Cook

(County)

Illinois

(State)

Kind of business

Own and Operate Apartment Building

EXCESS-PROFITS TAX COMPUTATION

- Items File.
- Net income for excess-profits computation (Item 28, Schedule A)
 - State value of capital stock as declared in your capital stock tax return for the year ended June 30, 1937 (or in your capital stock tax return for the year ended June 30, 1938, if your income tax fiscal year begins in 1937 and ended on or after July 31, 1938)
 - Enter here 10 percent of Item 2
 - Dividends received credit (80 percent of Schedule F, column 2)
 - Balance subject to excess-profits tax (Item 1 minus Items 3 and 4)
 - Amount taxable at 8 percent (8 percent of Item 5, but not more than Item 5)
 - Balance taxable at 12 percent (Item 5 minus Item 6)
 - Total excess-profits tax

3262 36

NORMAL TAX COMPUTATION

- Net income for normal tax computation (Item 31, Schedule A)
- Dividends received credit (80 percent of Schedule F, column 2)
- Dividends paid credit (for mutual investment companies)
- Balance subject to normal tax (Item 9 minus Item 10 or 11)
- Tax on portion of Item 13 not in excess of \$2,000
- Tax on portion of Item 13 in excess of \$2,000 and not in excess of \$15,000
- Tax on portion of Item 13 in excess of \$15,000 and not in excess of \$40,000
- Tax on portion of Item 13 in excess of \$40,000
- Total normal tax in Items 12 to 16
- Normal Tax on Corporations Not Subject to Graded Normal Tax Rates (to be used in lieu of the normal tax rates above)
- Stocks and trust companies (see Instruction 11)
- Insurance companies
- Corporations entitled to the benefits of section 251 of the Revenue Act of 1938
- Corporations organized under the China Trade Act, 1922
- Foreign corporations engaged in trade or business within the United States or having an office or place of business therein

3262 36

UNDISTRIBUTED PROFITS TAX COMPUTATION

(See Instruction 11 regarding corporations exempt from this tax)

- Net income for undistributed profits tax computation (Item 31, Schedule A)
- Normal tax (Item 17 above)
- Credit for holding company affiliate or national mortgage association (see Instruction 11) (b) and (c)
- Adjusted net income (Item 23 minus Items 24 and 25)
- Dividends paid credit (Item 12, Schedule M)
- Credit for amounts restricting dividend payments (see Instruction 11)
- Undistributed net income (Item 26 minus Items 27 and 28)
- Portion of Item 29 taxable at 7% \$5,000 or 10% of Item 26, whichever is greater (but not more than Item 29)
- Portion of Item 29 taxable at 12% 10% of Item 26 (but not more than Item 29 minus Item 20)
- Portion of Item 29 taxable at 17% 20% of Item 26 (but not more than Item 29 minus Items 20 and 21)
- Portion of Item 29 taxable at 22% 30% of Item 26 (but not more than Item 29 minus Items 20 to 22)
- Portion of Item 29 taxable at 27% (Item 29 minus Items 20 to 23)
- Total surtax in Items 20 to 24
- Total normal tax and surtax (Item 17 plus Item 25, or Item 14, 15, 20, 21, or 22)
- Less: Credit for income tax of a foreign country or a possession of a foreign country (see Instruction 11)
- Balance of tax (Item 36 minus Item 27)
- Excess-profits tax (Item 8 above)
- Total tax due (Item 36 plus Item 29)

3262 36

102568

Schedule A - NET INCOME COMPUTATION

- GROSS INCOME**
- Item and Instruction No.
- Gross sales (where inventories are an income-determining factor)
 - Less cost of goods sold (from Schedule D, 1)
 - Gross profit from sales (from 1 minus item 2)
 - Gross receipts (where inventories are not an income-determining factor)
 - Less cost of operations (from Schedule D, 2) (See Schedule)
 - Gross profit where inventories are not an income-determining factor (from 4 minus 5)
 - Interest on loans, notes, mortgages, bonds, bank deposits, etc.
 - Interest on obligations of the United States (from Schedule B, line 19 (a))
 - Rents
 - Royalties
 - Capital gain (or loss) (from Schedule E) (If a net loss, do not enter over \$2,000)
 - Dividends (from Schedule F)
 - Other income (state nature of income)
 - Total income in items 3, and 6 to 13, inclusive

46244 34
28812 38

17432 06

- DEDUCTIONS**
- Compensation of officers (from Schedule G)
 - Salaries and wages (not deducted elsewhere)
 - Rent
 - Repairs
 - Bad debts (from Schedule H)
 - Interest
 - Taxes (from Schedule I) (Do not include Federal income-profits tax)
 - Contributions or gifts (from Schedule J)
 - Losses by fire, storm, etc. (Submit schedule, see Instruction 23)
 - Depreciation (from Schedule M)
 - Depletion of mines, oil and gas wells, timber, etc. (Submit schedule, see Instruction 23)
 - Other deductions authorized by law (from Schedule L)
 - Total deductions in items 15 to 20, inclusive
 - Net income for excess-profits tax computation (Item 14 minus Item 27)
 - Less: Federal income-profits tax (see Instruction 29)
 - Interest on obligations of the United States (Item 8, above)
 - Net income for income tax computation (Item 20 minus Items 28 and 30)

125 00
1059 37
5468 04

14040 81

20694 82
3262 36

3262 36

Schedule B - RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

- Total distributions to stockholders charged to earned surplus during the taxable year
- Contributions or gifts (excess over 5 percent limitation)
- Federal income taxes
- Income taxes of United States possessions or foreign countries if claimed as a credit in whole or in part in item 27, page 1 of return
- Federal taxes paid on tax-free government bonds
- Special improvement taxes leading to increase the value of the property assessed
- Employees' reserves and capital expenditures charged to expense on the books
- Insurance premiums paid on the life of any officer or employee where the corporation is directly or indirectly a beneficiary
- Unallowable interest incurred in purchasing or carrying exempt interest obligations
- Excess of capital loss, if any, over amount allowable as a deduction in item 11, Schedule A
- Additions to surplus reserves (for each reserve separately)
 -
 -
 -
 -
- Other unallowable deductions
 -
 -
 -
 -
- Adjustments for tax purposes not recorded on books (list item)
 -
 -
 -
 -
- Bondy debits to earned surplus (list item)
 - 1936 Operating Expenses
 -
 -
 -
- Earned surplus and undivided profits as shown by balance sheet at close of the taxable year (Schedule N)
- Total of items 1 to 15

2924 10

815 33

2685 78
6425 21

- Earned surplus and undivided profits as shown by balance sheet at close of preceding taxable year (Schedule N)
- Net income for income tax computation (Item 21, Schedule A)
- Non-taxable and partially exempt income
 - Interest on:
 - Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions
 - Obligations of United States issued on or before September 1, 1917, Treasury Notes, Treasury Bills, and Treasury Certificates of Indebtedness
 - United States Savings Bonds and Treasury Bonds owned in the principal amount of \$5,000 or less
 - United States Savings Bonds and Treasury Bonds owned in the principal amount of over \$5,000
 - Obligations of instrumentalities of the United States
 - Other non-taxable income (list item)
 -
 -
 -
 -
- Charges against surplus reserves deductible from income in the return (list item)
 -
 -
 -
 -
- Adjustments for tax purposes not recorded on books (list item)
 -
 -
 -
 -
- Bondy credits to earned surplus (list item)
 - Additional Depreciation
 - Allowable
 -
 -
- Total of items 17 to 22

1809 89
3262 36

7578 28

6425 21

NOTE.—Attach to this return and mark as Schedule B-1, B-2, etc., analyses of surplus reserves, if any, as shown by the balance sheets (Schedule M), additions to which are not deductible for income and excess-profits tax purposes.

Schedule D-1—COST OF GOODS SOLD (See Instruction 2)

Schedule D-2 — COST OF OPERATION

Schedule E.—CAPITAL GAINS AND LOSSES (From Sales or Exchanges Only) (See Instruction 1)

Total Gate Fee (same as item 1), \$1,000.00. If attended a course, \$1,000.00. If not attended a course, \$1,000.00.

If an estate name and address is given, it is assumed that the decedent was an individual. If the estate name and address is not given, it is assumed that the decedent was a corporation. If the estate name and address is given, it is assumed that the decedent was an individual. If the estate name and address is not given, it is assumed that the decedent was a corporation.

[illegible]

Total of columns 2, 3, and 4 (enter as item 12, Schedule A):

*Amount originally reported from corporations reported under the "Other Funds" A.R. 1932, and corporations deleted in the remedy of section 101 of the Revenue Act of 1933 which provided for the elimination of the "Other Funds" A.R. 1932.

Schedule C.—COMPENSATION OF OFFICERS (See Instruction 18)				
1. Name and Address of Officer	2. Official Title	3. Total Amount of Report	Percentage of Compensation with Interest 4. Interest 5. Principal	6. Amount of Compensation

Total Consumption of Offshore Center on item 15, March 1969

Subject: Chemistry Date: 10/10/19

Schedule M - BAD DEBTS (See instruction 19)

Loss	43420 66	375 00
Loss	43420 66	125 00

Schedule I.—TAXES (See Instruction 21)

Real Estate 4997 44
 Capital Stock 185 00
 Franchise 93 44
 Personal Property 50 00
 Social Security 142 76
 5468 64

Total (Enter as item 21, Schedule 4)

Schedule J.—CONTRIBUTIONS OR GIFTS (See Instruction 22)

Total (Enter as item 22, Schedule 4, subject to 5 percent limitation per Instruction 22)

Schedule K.—DEPRECIATION (See Instruction 23)

Furniture & Fixtures 1935 3907 59

Brick Building 1924 424609 19

1893 70 8015 89 3 Yrs. 7/10

164730 27 259874 98 3315 21 1/2 Yrs.

This corporation was organized in accordance with a plan of reorganization approved by Federal Court Under Section 77-B proceedings. This plan is being treated as a corporate reorganization under Section 13 of the Internal Revenue Act of 1934, and basis used for depreciation is that of predecessor corporation.

Total (Enter as item 24, Schedule 4)

Schedule L.—OTHER DEDUCTIONS (See Instruction 25)

Schedule M.—DISTRIBUTIONS TO STOCKHOLDERS AND DIVIDENDS PAID CREDIT (See Instruction 26)

(Enter the amount of Dividend or Profit of the Taxable Year or Out of Earnings or Profits Accumulated Since February 28, 1913, (Indicate Date 1913)

1. Cash
2. Assets other than cash or the corporation's own securities (See notes 1 and 5. Indicate nature of assets)
3. Treasury stock (See notes 1 and 5)
4. Obligations of the corporation (bonds, notes, scrip, etc.) (See notes 3 and 5)
5. Common stock of the corporation distributed to holders of common stock (See notes 3 and 5)
6. Preferred stock of the corporation distributed to holders of common stock (See notes 2, 4, and 5)
7. Common stock of the corporation distributed to holders of preferred stock (See notes 2, 4, and 5)
8. Preferred stock of the corporation distributed to holders of preferred stock (See notes 2, 4, and 5)
9. Optional—Medium of payment elected by stockholders:
 - (a) Cash
 - (b) Common stock (See notes 3 and 5)
 - (c) Other (See note 5. Specify nature)
10. Totals of items 1 to 9

DIVIDENDS PAID CREDIT

11. Taxable distributions (line 10, column 1)
12. Dividend carry-over from preceding taxable year (attach schedule of computation)
13. Dividends paid credit (Total of lines 11 and 12) (Enter as item 27, page 1)
14. Adjusted net income (line 26, page 1)
15. Dividend carry-over (line 13 minus line 14)

RECONCILIATION

16. Total distributions out of earnings or profits of the taxable year or out of earnings or profits accumulated since February 28, 1913 (Total of columns 1 and 2, line 10)
17. Total distributions charged to earned surplus and undivided profits, as shown on line 1, Schedule B
18. Total distributions during the taxable year regardless of source

If the amounts entered on lines 16, 17, and 18 are not the same, explain difference

Notes

1. Enter the lesser of the two following amounts determined as of time of distribution: (a) The adjusted basis to the holder of the corporation as provided in section 113 of the Revenue Act of 1936, as amended; or (b) the fair market value.
2. Enter the amount of the fair market value at time of distribution.
3. Enter the lesser of the two following amounts determined as of the time of distribution: (a) Fair value; or (b) fair market value.
4. Enter the amount of the fair market value at time of distribution.
5. Preferred stock for this purpose should be considered as stock which is preferred as to either dividends or assets, irrespective of actual designation.
6. Distributions in the form of notes to purchase assets or otherwise to stock or other obligations of the corporation should be entered in the "Other" column.

Schedule N - BALANCE SHEETS (See Instruction N)

Page 2

		Beginning of Taxable Year		End of Taxable Year	
		Amount	Total	Amount	Total
ASSETS					
1 Cash		3162 70	4306 99	1162 70	5516 69
2 Notes receivable		6060 49		2626 14	
3 Accounts receivable		7223 19		9828 88	
(a) Total of lines 2 and 3		6845 73	377 46	6970 73	2878 11
(b) Less reserve for bad debts					
4 Inventories					
(a) Raw materials					
(b) Work in process					
(c) Finished goods					
(d) Supplies					
5 Investments (Government obligations)					
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions					
(b) Obligations of the United States					
(c) Obligations of instrumentalities of the United States					
6 Other investments					
(a) Stocks of domestic corporations					
(b) Bonds of domestic corporations					
(c) Stocks and bonds of foreign corporations					
(d) Treasury stock					
(e) All other investments or loans					
7 Deferred charges			4102 68		1608 44
(a) Prepaid insurance, taxes, etc.					
8 Capital assets					
(a) Buildings		162000 00		162000 00	
(b) Machinery and equipment					
(c) Furniture and fixtures		3907 59		3907 59	
(d) Delivery equipment					
(e) Other depreciable assets					
(f) Total of lines (a) to (e)		165907 59		165907 59	
(g) Less reserve for depreciation		8778 70	157128 89	14941 23	150966 36
(h) Depreciable assets					
(i) Less reserve for depletion			50000 00		50000 00
(j) Land					
9 Other assets (Transfer below)					
10 Total Assets			215916 02		211969 60

LIABILITIES AND CAPITAL

11 Accounts payable			491 62		300 00
12 Bonds, notes, and mortgages payable (with original maturity of less than 1 year)					
13 Bonds, notes, and mortgages payable (with original maturity of 1 year or more)			18500 00		18500 00
14 Accrued expenses					
(a) Interest		282 62		282 62	
(b) Taxes		7162 17		6335 84	
(c) All others		111 15	7555 94	836 34	7454 80
15 Other liabilities (Transfer below)					
Prepaid Rents		678 75	678 75		1036 00
16 Surplus reserve (Transfer below)					
Telephone Slugs					25 00
17 Capital stock					
(a) Preferred stock		31580 00	31580 00	31580 00	31580 00
(b) Common stock			155300 42		152388 02
18 Paid-in or capital surplus			1809 89		2685 78
19 Retained surplus and undivided profits					213969 60
20 Total Liabilities and Capital			215916 02		211969 60

Schedule O - CHANGES IN CORPORATION'S OBLIGATIONS AND CAPITAL STOCK (See Instruction O)

1 Total cash receipts during taxable year from sale of corporation's non-interest-bearing obligations with original maturity of 1 year or more and capital stock

2 Total cash expenditures during taxable year for purchase or retirement of corporation's own interest-bearing obligations with original maturity of 1 year or more and capital stock

3 Difference between lines 1 and 2

* Preferred stock for this purpose should be considered as stock which is preferred as to either dividends or assets, irrespective of formal designation

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Claridge Apartments Company
Room #937—29 S. La Salle Street
Chicago, Illinois

Schedule A—Item #5—Cost of Operations

Management Commission	\$ 2767.37
Salaries	4734.16
Laundry & Curtain Cleaning	546.26
Ash Removal & Exterminating	192.75
General Supplies	669.43
Electric Current	3514.00
Gas	974.95
Water	624.49
Electric Supplies	208.26
Fuel	2703.98
Painting & Decorating	4789.41
Repairs and Maintenance	1819.37
Shades & Cleaning	170.68
Advertising	134.71
Telephone	142.48
Stationery & Supplies	128.38
Furniture Rental	934.33
Miscellaneous	315.14
Insurance	915.46
Legal & Collection	726.52
Trustee's Fees	204.34
Depository Fees, expenses, etc.	421.69
Accounting & Auditing	1078.17
Mortgage Expense	95.85
Total	<u>\$28812.18</u>

Form 787
INTERNAL REVENUE SERVICE
JULY 1937

1937 RETURN OF CAPITAL-STOCK TAX For Year Ending June 30, 1937

DUPLICATE—PAGE 3

FIRST ILLINOIS
JULY 1937
1937
JULY 1937

DOMESTIC CORPORATIONS

This return must be filed, in triplicate, and received by the Collector of Internal Revenue for your district on or before July 31, 1937. The tax must be paid on or before that date.

To be stamped by collector, showing district and date received

- 1 Name **CHALICE APARTMENTS COMPANY**
- 2 Address **Room 840 - 310 South Michigan Avenue - Chicago, Illinois**
- 3 Name of parent company, if any
- 4 Name of subsidiary, if any
- 5 Nature of business in detail **OWNING and OPERATING an Apartment Building**
- 6 Incorporated or organized in State of **Illinois** Month **May** Day **28** Year **1935**
- 7 Was a capital-stock tax return filed for the preceding taxable year ended June 30, 1936? **Yes** If filed under a different name, state the name
- 8 Date of close of last income-tax taxable year ended on or prior to June 30, 1937, or, if newly organized corporation, having no income-tax taxable year ended on or prior to June 30, 1937, date of organization **December 31, 1934**

Corporations making an original declaration of value upon this return must enter the amount of such declared value in item 9. This block is not to be used by a corporation which established its original declared value for the first return for the year ended June 30, 1937.

9 ORIGINAL DECLARED VALUE OF ENTIRE CAPITAL STOCK
(The value declared must be definite and complete. A value must be declared for every share of stock except shares of stock exempt from the tax.)

Corporations which have established their original declared value by the return for the year ended June 30, 1936, must enter the declared value as provided for in Schedule I on page 2 of this return and then enter the amount of the adjusted declared value in item 10.

10 ADJUSTED DECLARED VALUE OF ENTIRE CAPITAL STOCK (Last item of Schedule I, page 2) **104,287.70**

- 11 EXEMPTIONS.—The Act provides for an exemption from the tax only on the grounds indicated below. Corporation claiming exemption must (1) report a value for the capital stock under item 9 or 10, (2) check the appropriate block, and (3) submit with the return a full statement of the evidence specified under the block checked.
 - ☐ Corporation exempt from income tax under Section 101, Revenue Act of 1936. (1) State under what exemption of section 101.
 - ☐ Insurance company subject to tax under section 201, 204, or 207, Revenue Act of 1936. (1) State under what exemption of section 201, 204, or 207.
 - ☐ Corporation not doing business. (1) Furnish information required by instruction 1.

COMPUTATION OF TAX		FOR USE OF TAXPAYER	FOR USE OF DEPARTMENT
12 Amount reported in item 9 or 10	\$	104,287.70	
13 Tax at rate of \$1 for each full \$1,000 in item 12 (round cents)	\$	104	
14 Penalty of _____ percent for delinquency in filing return			
15 Interest at 6% per annum beginning August 1, 1937			
16 Total tax, penalty, and interest	\$	104.00	

I, the undersigned, **M. C. Ashman**, (Name of president, vice president, or other principal officer) Vice-President
and _____ (Name of treasurer, assistant treasurer, or chief accounting officer) of the corporation for which this

return is made, being severally duly sworn, each for himself depose and say that this return, including any accompanying schedules and statements, has been examined by him and as to the best of his knowledge and belief, a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1936, as amended, and the Regulations issued thereunder.

Sworn to and subscribed before me this _____ day of _____, 1937.
Notary Public (Name) _____ Vice-President (Name) _____
Corporate Seal (Name) _____

The schedules on this page must be filled in by every corporation making adjustments to an original declared value for the capital stock established by the return for the year ended June 30, 1935. See instructions 5 to 9, inclusive.

SCHEDULE I. ADJUSTMENT OF ORIGINAL DECLARED VALUE OF ENTIRE CAPITAL STOCK FOR ALL TRANSACTIONS DURING THE INCOME-TAX TAXABLE YEAR ENDED December 31, 1935

Original declared value as established by the first return for the taxable year ended June 30, 1935

\$ 200,000.00

Additions

- (1) Total cash paid in for stock or shares (see instruction 7, item 1)
- (2) Fair market value of all property received for stock or shares (see instruction 7, item 1)
- (3) Paid-in surplus and contributions to capital (see instruction 7, item 2)
- (4) Net income (see instruction 7, item 3)
- (5) Excess of income wholly exempt from tax over amount disallowed as deductions by section 21 (a) (1) of the Revenue Act of 1934 or 1936 (see instruction 7, item 4)
- (6) Deductions allowable for income tax purposes (see instruction 7, item 5)

Total additions

TOTAL BEFORE DEDUCTIONS

\$ 200,000.00

Deductions

- (A) (1) Total cash distributed in liquidation to shareholder (see instruction 7, item A)
- (2) Fair market value of all property distributed in liquidation to shareholders (see instruction 7, item A)
- (B) Distributions of earnings or profits (see instruction 7, item B)
- (C) Excess of deductions allowable over gross income (see instruction 7, item C)

11,234.70

1,091.80

Total deductions

12,326.50

ADJUSTED DECLARED VALUE (see instruction 10, page 1)

\$ 187,673.50

SCHEDULE II. ANALYSIS OF CHANGES IN CAPITAL STOCK AND SURPLUS

Capital Stock and Surplus at beginning of year

- 1 Capital stock Preferred 31,680.00
- Common 158,684.24
- 2 Capital or paid-in surplus
- 3 Surplus reserves
- 4 Surplus and undivided profits 5,665.26

Additions - Capital transactions

- 5 Total cash and fair market value of property paid in for stock or shares (total of items 1 and 2, Schedule I)
- 6 Paid-in surplus and contributions to capital (item 2, Schedule I)
- 7 Other additions (to be detailed)

adjustment of

reorganization expenses

200.00

Additions - Revenue transactions

- 8 Net income (item 4, Schedule I)
- 9 Income wholly exempt from income tax (This total less the amount referred as item 12 of this schedule should correspond with item 4, Schedule I) (see instruction 7, item 4)
- 10 The amount of the disallowed deduction allowable for income tax purposes (item 5, Schedule I) (see instruction 7, item 5)
- 11 Other additions (to be detailed)

Additional depreciation

claimed

7,676.38

Additional repairs claimed

1,081.04

Total

\$ 186,489.80

Deductions - Capital transactions

- 12 Liquidating distributions (total of items A and B, Schedule I) 3,388.00
- 13 Other distributions (item B, Schedule I) 11,234.70
- 14 Excess and amount of distributions in liquidation (see instruction 7, item A)
- 15 Other deductions (to be detailed)

Deductions - Revenue transactions

- 16 Excess of deductions allowable over gross income and claimed on income tax return (item C, Schedule I) 1,091.80
- 17 Deductions disallowed by sec. 24 (a) (8), 1934 or 1936 Act (see item 9 of this schedule)
- 18 Other deductions (to be detailed)
- Unallowable tax credits 20.79
- Prior years taxes 740.03
- Prior years overrating expenses 84.57
- 1935 Federal Capital Stock Tax 442.60

Capital Stock and Surplus at end of year

- 19 Capital stock Preferred 31,680.00
- Common 155,999.42
- 20 Capital or paid-in surplus
- 21 Surplus reserves
- 22 Surplus and undivided profits 1,000.29

Total

\$ 208,689.80

*Enter values shown by the books if different from values obtained in Schedule I and explain difference.

1938 UNITED STATES CORPORATION INCOME AND EXCESS-PROFITS TAX RETURN 1938

For corporations having total receipts of not more than \$500,000 and a net income of not more than \$100,000, as determined by the instructions to this form.

Under the name

For Calendar Year 1938

or Fiscal Year beginning 1938, and ending at 1939

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

No. 276
City 420125
State

CLARIDGE APARTMENTS COMPANY

29 South La Salle Street - Room 937

Chicago

Cook

Illinois

Kind of business Own and Operate Apartment Building

ADJUSTED NET INCOME COMPUTATION

Item No.	Amount	Less returns and allowances	Amount
1. Gross sales (where inventories are an income-determining factor)			
2. Less cost of goods sold (from Schedule B-1)			
3. Gross profit from sales (Item 1 minus Item 2)			
4. Gross receipts (where inventories are not an income-determining factor)	46537 87		
5. Less cost of operations (from Schedule B-2)	24311 22		
6. Gross profit where inventories are not an income-determining factor (Item 4 minus Item 5)			22103 65
7. Interest on loans, notes, mortgages, bonds, bank deposits, etc. (See Instruction 15-11)			
8. Interest on obligations of the United States (from Schedule A, line 19 (a) (4)). (See Instruction 15-12)			
9. Dividends (See Instruction 15)			
10. Royalties (See Instruction 20)			
11. (a) Capital gains (or loss) (from Schedule C). If a net loss, do not enter over \$2,000.			
(b) Gain or loss from sale or exchange of property other than capital assets (from Schedule D)			
12. Dividends (from Schedule E)			
13. Other income (state nature of income)			
14. Total income in Items 6, and 8 to 13, inclusive			22103 65
DEDUCTIONS			
15. Compensation of officers (from Schedule F)			
16. Salaries and wages (not deducted elsewhere)			
17. Rent (See Instruction 23)			
18. Repairs (See Instruction 24)			
19. Bad debts (from Schedule G)			
20. Interest (See Instruction 25)			
21. Taxes (from Schedule H). Do not include Federal income profits tax.			
22. Contributions or gifts paid (from Schedule I)			
23. Losses by fire, storm, shipwreck, or other casualty or theft. (Subject schedule see Instruction 26)			
24. Depreciation (from Schedule J)			
25. Depletion of mines, oil and gas wells, timber, etc. (Subject schedule see Instruction 21)			
26. Other deductions authorized by law (from Schedule K)			
27. Total deductions in Items 15 to 26, inclusive			19192 58
28. Net income for excess-profits tax computation (Item 14 minus Item 27)			2904 11
29. Less Federal income profits tax (See Instruction 31)			
30. Net income (Item 28 minus Item 29)			2904 11
31. Less Interest on obligations of the United States (Item 8, above)			
32. Adjusted net income (Item 30 minus Item 31)			2904 11

EXCESS-PROFITS TAX COMPUTATION (See Instruction 36)

Item No.	Amount	Rate	Amount
33. Net income for excess-profits tax computation (Item 30, above)	2904 11		
34. Value of capital assets as determined in your capital assets tax return for the year ended June 30, 1939, or for year ended June 30, 1938, if your income tax fiscal year begins in 1938 and ended on or after July 31, 1939	100000 00		
35. 10 percent of Item 34	10000 00		
36. Dividends received credit (60 percent of net, Item 8, above, but not in excess of 50 percent of Item 33, above)			
37. Balance subject to excess-profits tax (Item 33 minus total of Items 34 and 35)	10000 00		
38. Amount taxable at 6 percent (15 percent of Item 34, but not more than Item 37, and tax		6%	
39. Balance taxable at 12 percent (Item 37 minus Item 38, net 11, and tax		12%	
40. Total excess-profits tax (total of Items 38, net 11, and Item 39, net 11)			

INCOME TAX COMPUTATION

Item No.	Amount	Rate	Amount
41. A taxable net income (Item 32, above)	2904 11		
42. Dividends received credit (60% of net, Item 8, Schedule F, but not in excess of 50% of Item 41, above)			
43. Balance subject to income tax (Item 41 minus Item 42)			
44. Portion of Item 43 not in excess of \$5,000, and tax at 12% percent		12%	
45. Portion of Item 43 in excess of \$5,000 and not in excess of \$50,000, and tax at 14%		14%	
46. Portion of Item 43 in excess of \$50,000, and tax at 16% percent		16%	
47. Total income tax (total tax in net 11 of Items 44, 45, and 46)			
48. Less Credit for income taxes paid from foreign country or U. S. possession (allowable domestic corporation only). (See Instruction 38)			
49. Net income tax (Item 47 minus Item 48)			
50. Excess-profits tax (Item 40, above)			
51. Total tax due (Item 49 plus Item 50)			



Schedule A.—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

1. Total distributions to stockholders charged to earned surplus during the taxable year		18. Adjusted net income (item 32, page 1)	2885 78
2. Contributions or gifts (income over 3 percent limitation)		19. Excess and partially exempt income	2904 11
3. Federal income taxes	363 02	(a) Exempt on:	
4. Income taxes of United States possessions or foreign countries if claimed as a credit in whole or in part in item 4b, page 1		(1) Obligations of a State, Territory, or political subdivision thereof of the United States or possessions	
5. Federal loans paid on tax-free covenant bonds		(2) Obligations of United States issued on or before September 1, 1917, Treasury Notes, Treasury Bills, and Treasury Certificates of Indebtedness	
6. Special improvement taxes tending to increase the value of the property assessed		(3) United States Savings Bonds and Treasury Bonds issued in the principal amount of \$5,000 or less	
7. Replacements, repairs, and capital expenditures charged to expense on the books		(4) United States Savings Bonds and Treasury Bonds issued in the principal amount of over \$5,000	
8. Insurance premiums paid on the life of any officer or employee whose the corporation is directly or indirectly a beneficiary		(5) Obligations of instrumentalities of the United States	
9. Unallowable interest incurred in purchasing or carrying exempt interest obligations		(6) Other tax-exempt income (specify):	
10. Excess of capital loss, if any, over amount allowable as a deduction in item 11 (a), page 1		(1)	
11. Additions to surplus reserves (list each reserve separately):		(2)	
(a)		20. Charges against surplus reserves deducted from income in the return (specify):	
(b)		(a)	
(c)		(b)	
12. Other nondeductible deductions		21. Adjustments for tax purposes not recorded on books (specify):	
(a)		(a) Overestimated 1937:	
13. Adjustments for tax purposes not recorded on books (specify):		(b) Personal Property	11 23
(a)		(c) Real Estate Tax	414 76
(b)		(d) Capital Stock Tax	135 00
14. Ready credits to earned surplus (specify):		22. Ready credits to earned surplus (specify):	
(a) Additional Workmen's Compensation Insurance		(a) Additional Depreciation	7678 28
(b) ANRS - 1937	5 78	(b) allowable	
15. Earned surplus and undivided profits as shown by balance sheet at close of the taxable year (Schedule M)	11660 30	(c)	
16. Total of items 1 to 15	14029 10	23. Total of items 17 to 22	14029 10

Schedule B-1.—COST OF GOODS SOLD. (See Instruction 17)

1. Inventory at beginning of year	
2. Material or merchandise bought for manufacture or sale	
3. Salaries and wages	
4. Other costs per books. (Attach detailed schedule)	
5. Total (Items 1 to 4)	
6. Loss inventory at end of year	
7. Cost of goods sold (specify as item 8, page 1)	

Schedule B-2.—COST OF OPERATIONS. (See Instruction 18)

1. Salaries and wages	
2. Other costs (to be detailed):	
(a)	
(b)	
(c)	
(d)	
3. Total (enter as item 8, page 1)	

Schedule C.—CAPITAL GAINS AND LOSSES. (See Instruction 21)

1. Description of Property	2. Date Acquired	3. Gross Sales Price (Reduced price)	4. Cost or Other Basis	5. Expense of Sale and Cost of Improvement (Indicate in column 3 or 4 of March 1, 1941)	6. Depreciation Allowed for Allowable Basis (Indicate in column 3 or 4 of March 1, 1941)	7. Gain or Loss (Indicate whether gain or loss in column 7 and 8)
Total Gain (or Loss) (Enter as item 11 (a), page 1, but if entered in a loss, do not enter over \$2,000)						

Schedule D.—GAINS AND LOSSES FROM SALES OR EXCHANGES OF PROPERTY OTHER THAN CAPITAL ASSETS. (See Instruction 21)

1. Description of Property	2. Date Acquired	3. Gross Sales Price (Reduced price)	4. Cost or Other Basis	5. Expense of Sale and Cost of Improvement (Indicate in column 3 or 4 of March 1, 1941)	6. Depreciation Allowed for Allowable Basis (Indicate in column 3 or 4 of March 1, 1941)	7. Gain or Loss (Indicate whether gain or loss in column 7 and 8)
Total Gain (or Loss) (Enter as item 11 (b), page 1)						

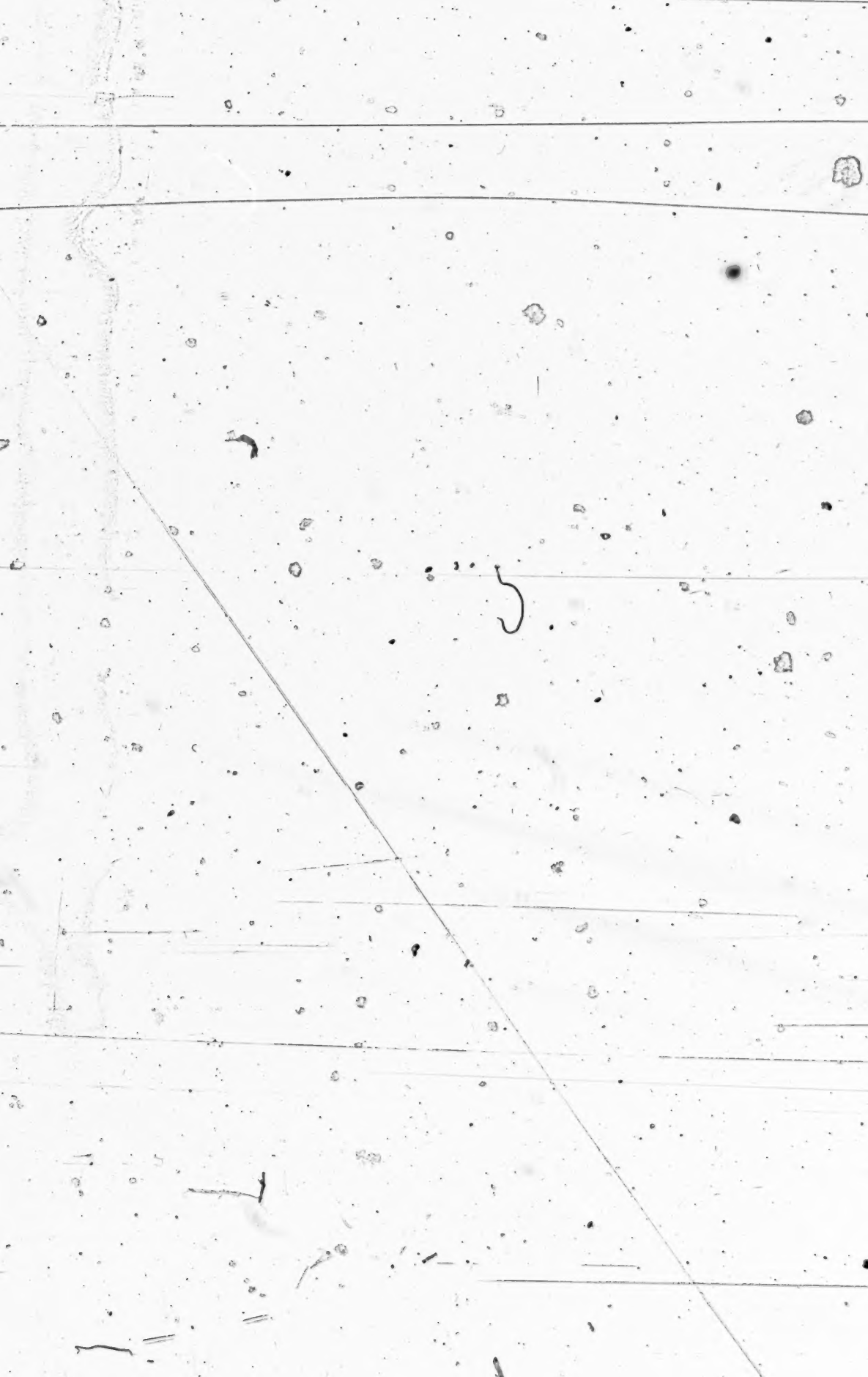
Supplemental information required for Schedules C and D

State with respect to each item of property reported in Schedules C and D: (1) how property was acquired; (2) whether at time of sale or exchange: (a) purchaser owned directly or indirectly more than 50 percent in value of its capital stock was owned directly or indirectly by or for the seller, individual or his family, and (c) where purchaser was a corporation, whether more than 50 percent in value of its capital stock was owned directly or indirectly by you. If an estate name and address of purchaser.

Schedule E.—INCOME FROM DIVIDENDS

1. Name and address of Paying Corporation	2. Character of Income (Indicate in column 2 of March 1, 1941)	3. Payments	4. Other Information
Totals			
Total of columns 2, 3, and 4. (Enter as item 13, page 1)			

These dividends received from corporations registered under the China Trade Act, 1911, and corporations related to the transfer of assets of the Republic of China, which dividends should be reported in column 1.



Schedule F—COMPENSATION OF OFFICERS (See instruction 27)

1. Name and Address of Officer	2. Official Title	3. Year (Month- to- Month)	4. Compensation for Services		5. Amount of Compensation
			A. Cash	B. Non-Cash	

Total Compensation of Officers (Enter as item 18, page 1)

Note.—Schedule F-1 (IN DUPLICATE) also must be filed with this return if compensation in excess of \$75,000 was paid to any officer or employee.

Schedule G—BAD DEBTS (See instruction 25) (See note 1)

1. Taxable Year	2. Not Income-Reported	3. Sales or Amount	4. Bad Debts Charged Off by Corporation & Not Reported on Schedule (See note 1)	5. Corporation's Share of Loss	6. Amount of Loss
1934					
1935					
1936	Loss	43,820 66			375 00
1937	Loss	46,244 85			125 00
1938 (See note 2)	\$2904.11	46,517 87			400 72

1. Check whether deduction claimed represents worthless debts charged off or is in addition to reserve.

2. In addition to the data required above, corporations claiming deductions on other than a reserve basis must submit the information specified in instruction 25.

3. Not including securities which are capital assets, designated to be worthless and charged off within the taxable year, which should be reported in Schedule C.

Schedule H—TAXES (See instruction 27)

1. Name	2. Amount	3. Name and Address of Corporation	4. Amount
Real Estate	906 72		
Capital Stock	100 00		
Franchise	46 47		
Personal Property	34 17		
Social Security Tax	194 82		
Sales Tax	10 92		
Total (Enter as item 21, page 1)	5,297 70		

Schedule I—CONTRIBUTIONS OR GIFTS PAID (See instruction 28)

1. Name	2. Amount	3. Name and Address of Corporation	4. Amount
Real Estate	906 72		
Capital Stock	100 00		
Franchise	46 47		
Personal Property	34 17		
Social Security Tax	194 82		
Sales Tax	10 92		
Total (Enter as item 21, page 1, subject to 3 percent limitation) (See instruction 28)	5,297 70		

Schedule J—DEPRECIATION (See instruction 29)

1. Kind of Property (If building, state material of which constructed)	2. Date Acquired	3. Cost or Other Basis	4. Accum. Dep. at End of Year	5. Depreciation for Year	6. Book Value at End of Year	7. Life in Years	8. Rate of Depreciation	9. Total Depreciation
Brick Building	1924	\$24609 19	711 26	27468 55	\$21860 64	33 1/2	80%	\$17738 28
Furniture-Fixtures	1935	3907 59		3196 23	711 36	7	20%	1773 07
Refrigeration	1934	6519 84			6519 84	8	25%	1629 96
Total (Enter as item 24, page 1)								19362 31

This corporation was organized in accordance with a plan of reorganization approved by Federal Court under Section 77A of the Revenue Act 1934. This corporation is being treated as a corporate reorganization under Section 112 of Revenue Act 1934 and basis used for depreciation is that of predecessor corporation.

Schedule L—DISTRIBUTIONS TO STOCKHOLDERS

1. Name and Address of Stockholder		2. Amount	3. Date
1. Cash			
2. Assets other than cash or the corporation's own securities (See notes 1 and 2). (Indicate nature of assets)			
3. Treasury stock (See notes 1 and 2)			
4. Obligations of the corporation (bonds, notes, etc.) (See notes 3 and 4)			
5. Common stock of the corporation distributed to holders of common stock (See notes 5 and 6)			
6. Preferred stock of the corporation distributed to holders of common stock (See notes 5, 6, and 7)			
7. Common stock of the corporation distributed to holders of preferred stock (See notes 5, 6, and 8)			
8. Preferred stock of the corporation distributed to holders of preferred stock (See notes 5, 6, and 9)			
9. Options—Manner of payment stated by stockholder			
(a) Cash			
(b) Common stock (See notes 5 and 6)			
(c) Other (See note 1). (Specify nature)			
10. Total of items 1 to 9			

1. Enter the basis of the two following amounts determined as of time of distribution: (a) The adjusted basis in the hands of the corporation as provided in section 112 of the Revenue Act of 1934, or (b) the fair market value.

2. Enter the amount of the fair market value at time of distribution.

3. Enter the basis of the two following amounts determined as of time of distribution: (a) Fair value, or (b) fair market value.

4. Preferred stock for this purpose should be considered as stock which is preferred as to other dividends or assets, irrespective of formal designation.

5. Distribution in the form of rights to purchase stock or securities of the corporation should be entered in the same column as the stock, bonds, or other obligations for which rights were distributed.

ASSETS					
1. Cash		8416 69		8416 69	
2. Notes and accounts receivable		300 02		300 02	
Less reserve for bad debts		7931 06		7931 06	
3. Inventories					
(a) Raw materials					
(b) Work in process					
(c) Finished goods					
(d) Supplies					
4. Investments (Government obligations)					
(a) Obligations of a State, Territory, the political subdivisions thereof, or the District of Columbia or United States possessions					
(b) Obligations of the United States					
(c) Obligations of instrumentalities of the United States					
5. Other investments (Receivables)					
6. Capital assets					
(a) Depreciable assets (Reserve) Building	162000 00		162000 00		
Furniture and fixtures	3907 59		3907 59		
Refrigerators	165907 59		165907 59		
Total depreciable assets	165907 59		165907 59		
Less reserve for depreciation	14941 23		14941 23		
(b) Depreciable assets					
Less reserve for depletion					
(c) Land		50000 00		50000 00	
7. Other assets (Reserve)					
Deferred Charges		1608 44		1608 44	
8. Total Assets		213 69 69		213 69 69	
LIABILITIES					
9. Accounts payable		300 00		300 00	
10. Bonds, notes, and mortgages payable					
(a) With original maturity of less than 1 year					
(b) With original maturity of 1 year or more		18500 00		18500 00	
11. Accrued expenses (Reserve)					
Interest	282 62		282 62		
Taxes	6135 84		6135 84		
Others	836 31		836 31		
12. Prepaid Rent		1036 00		1036 00	
13. Surplus reserves (Reserve)					
Telephone slugs		25 00		25 00	
14. Capital stock					
(a) Preferred stock					
(b) Common stock	31580 00		31580 00		
15. Paid-in or capital surplus		152388 02		152388 02	
16. Earned surplus and undivided profits		2685 78		2685 78	
17. Total Liabilities		213 69 69		213 69 69	

QUESTIONS

1. Business classification (See instructions 16) Own and operate apartment building
2. If engaged in more than one of the business classifications indicated in instruction 16, state on the two lines above the two businesses accounting for the greater part of the total receipts, and the approximate percentage accounted for by each of the two businesses. If engaged in other trades, also indicate the number of items as of the end of the taxable year
3. Date of incorporation May 28, 1935
4. State or country
5. Principal office where your return for the preceding year was filed Chicago, Illinois
6. The corporation's books are in care of C. Henry
7. Located at 29 S. La Salle St. - Room 937
8. Is the corporation a personal holding company within the meaning of section 602 of the Revenue Act of 1936? No If so, an additional return on Form 1120-B must be filed
9. Is this a consolidated return of railroad corporations? No If so, return from the collector of internal revenue for your district on Form 991, Affiliations Schedule, which shall be filed in, sworn to, and filed as a part of the return
10. If this is not a consolidated return of railroad corporations, did you: (a) own at any time during the taxable year 50 percent or more of the voting stock of another corporation either domestic or foreign or (b) did any corporation, individual, partnership, trust, or association own at any time during the taxable year 50 percent or more of your voting stock? No If the answer is "yes," attach separate schedule showing with respect to each: (1) Name and address; (2) percentage of stock owned; (3) date stock was acquired; and (4) the collector's office in which the income tax return of such corporation, individual, partnership, trust, or association for the last taxable year was filed
11. Was the income of this corporation included in a consolidated return for any prior year? No If so, give name and address of corporation which filed the consolidated return and the last year for which such return was filed

which such return was filed

Was the corporation in any way an outgrowth, result, reorganization, or reorganization of a business or businesses in existence during the year of any prior year since December 31, 1917? Yes If answer is "yes," give name and address of each predecessor business and the date of the change in entity

Claridge Building Corporation

August 1, 1935

Upon each change, were any asset values determined or determined? If answer is "yes," closing balance sheets of all business and opening balance sheets of new business must be furnished; otherwise, furnished herewith

11. Is the return made on the basis of cash receipts and disbursements? No If not, describe fully what other basis or method was used in computing net income Accrual basis of accounting

12. State whether the inventory at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower. Fully state why used, and the date in which such inventory was taken

None

JAN 11 1940

13. Did the corporation make a return of income for the year 1935 and 1936 on Form 1000 as instructed in 10-11 for the taxable year 1935 and 1936? No

14. Did the corporation at any time during the taxable year 1935 and 1936, or at any time during the taxable year 1935 and 1936, have any stock of a foreign corporation? No If answer is "yes," attach schedule as required by instruction 13-2

AFFIDAVIT (See instructions 7)

We, the undersigned, president (or vice president, or other principal officer, and treasurer or assistant treasurer, or chief accounting officer, or other officer) of the corporation for which this return is made, being severally duly sworn, each for himself, depose and say that this return, including any accompanying schedule and statement, has been examined by him and as to the truth of his knowledge and belief a true, correct and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1936 and the Regulations issued thereunder.

Subscribed and sworn to before me this 1st day of Feb 1937

Notary Public

Walter Hamilton

Notary Public

Charles J. Harris

AFFIDAVIT (See instructions 7)

I, the undersigned, declare that I have prepared this return for the person named herein and that the return, including any accompanying schedule and statement, is a true, correct and complete statement of all the information required by the law and the Regulations issued thereunder, and that I have no knowledge of any fraud or other illegal act in connection with the preparation of this return.

Subscribed and sworn to before me this 1st day of Feb 1937

Notary Public

Robert Harris

Notary Public

Charles J. Harris

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Claridge Apartments Company
29 South La Salle Street—Room 937
Chicago, Illinois

Schedule A—Item #5 Cost of Operations

Management Commission	\$ 2297.69
Property Management Fee	1200.00
Salaries	4259.77
Laundry & Curtain Cleaning	740.16
Ash Removal and Exterminating	195.00
General Supplies	52.61
Electric Current	3023.39
Gas	863.72
Water	443.24
Electric Light Bulbs	243.52
Fuel	2648.87
Painting & Decorating	3122.28
Repairs & Maintenance	2108.34
Shades & Cleaning	81.12
Advertising	347.37
Telephone	244.02
Stationery & Supplies	222.30
Miscellaneous	204.30
Insurance	1081.12
Legal & Auditing	625.62
Furniture & Equipment Repairs & Maintenance	132.89
Kitchen Utensils	15.80
Linens	236.09
Tax Services	25.00
Total	<u>\$24414.22</u>

1938 RETURN

CAPITAL-STOCK TAX

For Year Ending June 30, 1938

DOMESTIC CORPORATIONS

FIRST

ILLINOIS

Assessment Last, Fourth 22A

AUG

Month

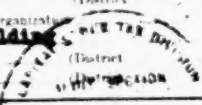
42 1/2

Pay

This return must be filed, in triplicate, and received with remittance by the collector for your district on or before July 31, 1938. (See instruction 7, page 8.)

To be stamped when by collector, showing district and date received

- 1 Name **CLARIDGE APARTMENTS COMPANY**
- 2 Address **Room 937 - 29 South La Salle Street Chicago, Illinois**
- 3 Incorporated or organized in State of **Illinois** Month **May** Day **28** Year **1935**
- 4 Was a 1937 capital stock tax return filed? **Yes** Name under which filed, if different, attach statement explaining fully
- 5 Date of close of last income-tax year ended prior to July 1, 1938 **December 31, 1937** Was an income tax return filed for that year? **Yes** Name under which filed
- 6 Nature of business in detail **Buying and Operating an Apartment Building**
- 7 Name of parent company, if any
- 8 Name of subsidiary, if any



DECLARED VALUE OF ENTIRE CAPITAL STOCK \$ 100,000.00

- 10 EXEMPTIONS. The Act provides for exemption from the tax only on the grounds indicated below. Corporation must (1) declare a value for the capital stock under item 9, (2) check the appropriate box, (3) attach in support of the basis of the claim, and (4) submit with the return a full statement of the evidence specified under the check checked.
- ☐ Corporation exempt from income tax under section 101, Revenue Act of 1938. (1) State under which subsection of section 101
- ☐ Insurance company subject to tax under section 201, 204, or 207, Revenue Act of 1938. State which section
- ☐ Corporation not doing business. (1) Furnish information required by instruction 6. (2) Declare value of capital stock in item 9 above

COMPUTATION OF TAX	PAID IN BY TAXPAYER	PAID IN BY DEPARTMENT
11 Declared value (must be identical figure entered in item 9)	100 000	
12 Tax at rate of \$1 for each full \$1,000 in item 9	100	
13 Penalty of _____ percent for delinquency in filing return		
14 Interest at 6 percent per annum beginning Aug 1, 1938		
15 Total tax, penalty, and interest	100	
16 State amounts of outstanding capital stock and surplus as of date of the close of income tax taxable year reported in item 5 above. (If not stock organization, so indicate and attach statement of net worth)		
	NUMBER OF SHARES	PAID IN BY TAXPAYER PER SHARE
Capital stock - Preferred		
Common		
Capital or paid-in surplus	XXXXXXXXXX	XXXXXXXXXX
Surplus reserves	XXXXXXXXXX	XXXXXXXXXX
Surplus and undivided profits	XXXXXXXXXX	XXXXXXXXXX

DUPLICATE

LAKE VIEW COOK COUNTY, ILLINOIS

1930

1930 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
200 x 144	200	1.072		42880
50 x 144	200	1.072	20	2144
LOT SIZE 200 x 144 TOTAL LAND				45024

1930 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION	% COND.
55682	3.10	172614	GOOD FAIR BAD	85
CUBIC CONTENTS CLASS				
GARAGE TYPE FLOOR ROOF SIZE AREA UNIT PRICE NEW COST % COND.				
SHEDS				

1931 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
200 x 144	200	1.072		42880
50 x 144	200	1.072	20	2144
LOT SIZE 200 x 144 TOTAL LAND				45024

1931 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION	% COND.
55682	3.10	172614	GOOD FAIR BAD	85
CUBIC CONTENTS CLASS				
GARAGE TYPE FLOOR ROOF SIZE AREA UNIT PRICE NEW COST % COND.				
SHEDS				

1932 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
200 x 144	150	1.072		32160
50 x 144	150	1.072	20	1608
LOT SIZE 200 x 144 TOTAL LAND				33768

1932 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION	% COND.
55682	3.70	206283	GOOD FAIR BAD	74
CUBIC CONTENTS CLASS				
GARAGE TYPE FLOOR ROOF SIZE AREA UNIT PRICE NEW COST % COND.				
SHEDS				

1933 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
200 x 144	150	1.072		32160
50 x 144	150	1.072	20	1608
LOT SIZE 200 x 144 TOTAL LAND				33768

1933 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION	% COND.
55682	3.70	206283	GOOD FAIR BAD	74
CUBIC CONTENTS CLASS				
GARAGE TYPE FLOOR ROOF SIZE AREA UNIT PRICE NEW COST % COND.				
SHEDS				

1934 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
200 x 144	150	1.072		32160
50 x 144	150	1.072	20	1608
LOT SIZE 200 x 144 TOTAL LAND				33768

1934 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION	% COND.
55682	3.70	206283	GOOD FAIR BAD	74
CUBIC CONTENTS CLASS				
GARAGE TYPE FLOOR ROOF SIZE AREA UNIT PRICE NEW COST % COND.				
SHEDS				

1935 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
200 x 144	150	1.072		32160
50 x 144	150	1.072	20	1608
LOT SIZE 200 x 144 TOTAL LAND				33768

1935 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION	% COND.
55682	3.70	206283	GOOD FAIR BAD	74
CUBIC CONTENTS CLASS				
GARAGE TYPE FLOOR ROOF SIZE AREA UNIT PRICE NEW COST % COND.				
SHEDS				

146721

106719

691

694

108104

1939 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
200 x 144	130	1044		271 44
50 x 125	130	1000	2-2	1300
				284 44
LOT SIZE	TOTAL LAND			

A 1939				
LAND	284 44	105 25		
BLDGS.	1 224 83	453 19		
TOTAL	1 509 27	558 44		
MEMO				

1943 LAND VALUATION

FRONT AND DEPTH	UNIT PRICE	DEPTH FACTOR	CORNER FACTOR	VALUE
LOT SIZE	TOTAL LAND			

A 1943				
LAND				
BLDGS.				
TOTAL				
MEMO				

1939 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION			% COND.
55682	3.25	1 809 66	GOOD	FAIR	SAD	67
CUBIC CONTENTS	CLASS		LACK OF UTILITY			OR OBSO-LESCENCE
						17 AGE
GARAGE	TYPE	FLOOR	ROOF	SIZE	AREA	UNIT PRICE
8 FIN	BSMT	Room				935
SHEDS						
4 BSMT	BATH					938
						66

BASE PRICE	3.25
BASEMENT	
FIN. ATTIC	
HEAT	
ENCLOSED PORCH	
TOTAL	

1 212 47

617

619

224 83

1943 BUILDING APPRAISAL

SQUARE FEET	UNIT PRICE	NEW COST	CONDITION			% COND.
			GOOD	FAIR	SAD	
CUBIC CONTENTS	CLASS		LACK OF UTILITY			OR OBSO-LESCENCE
						AGE
GARAGE	TYPE	FLOOR	ROOF	SIZE	AREA	UNIT PRICE
SHEDS						

BASE PRICE	
BASEMENT	
FIN. ATTIC	
HEAT	
ENCLOSED PORCH	
TOTAL	

8-2 = 156

8-3 = 54

9-2 = 180

100 BATHS

100 BATHS

100 BATHS

100 BATHS

100 BATHS

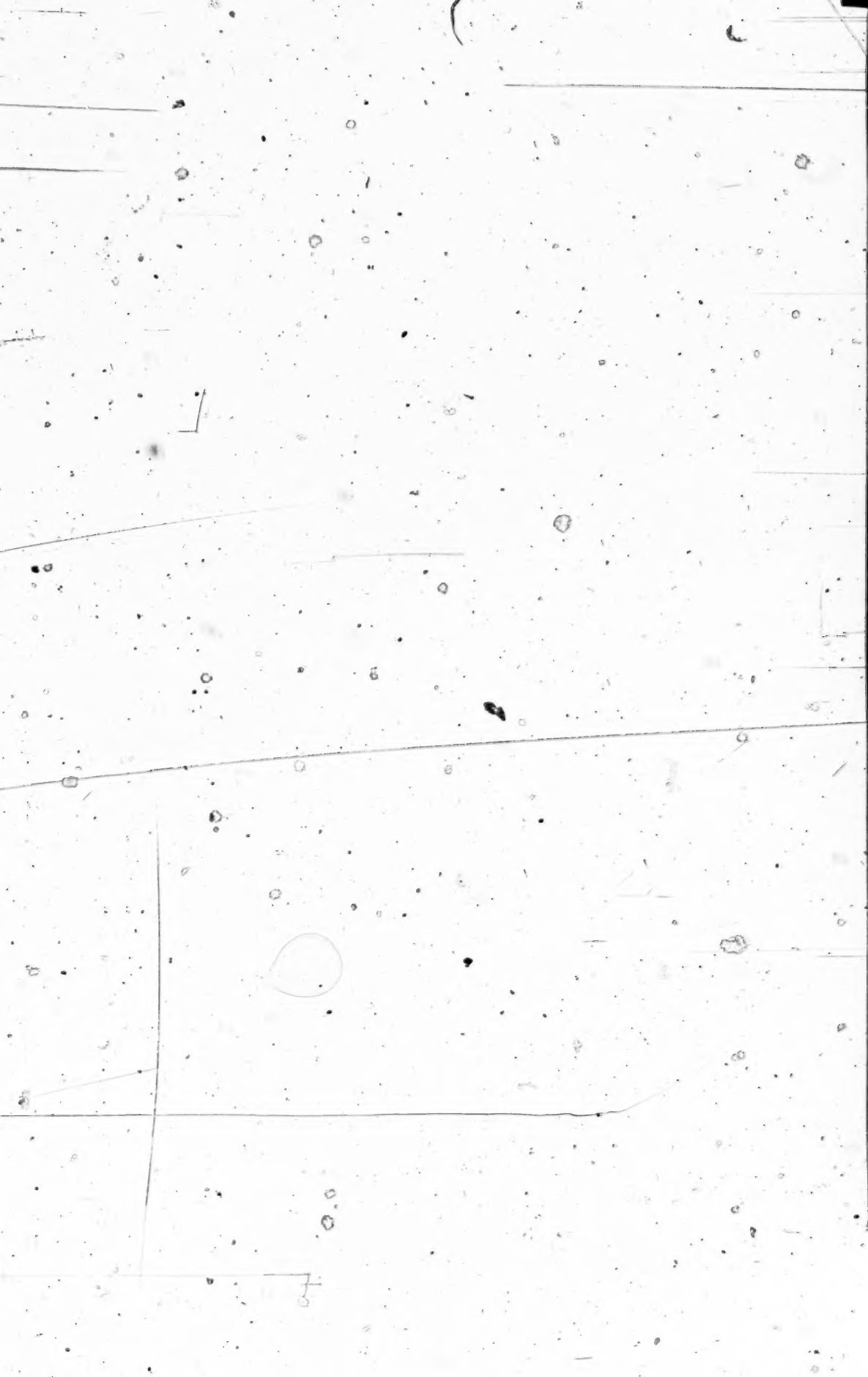
55682 = 265 WS 275 AV. RM AREA

210

210 = 21 AV RMS PER RPT

96

UNIT PRICE = 370



139

RESPONDENT'S EXHIBIT F.

and

Whereas, in accordance with the provisions of said Reorganization Plan as amended, Claridge Building Corporation and Minnie H. Case are required to convey to this corporation the property described in said Reorganization Plan as amended, and this corporation is required to issue 3078 shares of its common stock without par value, to enter into a trust agreement, to execute indemnification agreements, to enter into a management contract, to assume and agree to pay the unpaid foreclosure and reorganization expenses before any dividends shall be declared or paid upon its stock, to pay to Minnie H. Case the sum of \$1400.00 for the personal property to be conveyed by her to this corporation, and to keep and perform all other covenants, conditions and agreements in said Reorganization Plan as amended contained which said Reorganization Plan as amended contemplates that the corporation shall keep and perform; all in the manner provided in said Reorganization Plan as amended; and

Whereas, in the opinion of the Board of Directors of this corporation, the property to be conveyed to this corporation in accordance with said Reorganization Plan as amended (exclusive of the personal property to be conveyed to this corporation by Minnie H. Case), after taking into consideration the liabilities to be assumed by the corporation pursuant thereto (exclusive of the sum of \$1400.00 to be paid Minnie H. Case for the personal property to be conveyed by her to this corporation), is of the value of \$189,266.22, computed as follows:

Land	\$ 50,000.00
Building	162,000.00
(exclusive of personal property to be conveyed to this corporation by Minnie H. Case)	2,600.00
	<hr/>
	\$214,600.00
Less liabilities to be assumed by the corporation (exclusive of the sum of \$1400.00 to be paid Minnie H. Case for the personal property to be conveyed by her to this corporation)	25,333.78
	<hr/>
	\$189,266.22

and

Whereas, in the opinion of the Board of Directors of this corporation, it is for the best interests of this corporation that said Reorganization Plan as amended be consummated;

Now, Therefore, Be It Resolved: That upon the conveyance to this corporation of the property described in said Reorganization Plan as amended, and upon the substantial consummation of said Reorganization Plan as amended, the President and Secretary of this corporation be and they are hereby authorized and directed to issue 3078 shares of common stock of this corporation without par value (including the 20 shares issuable to the original subscribers which have been paid for in cash in the amount of \$1,000.00 and have been available for issuance under said Reorganization Plan as amended, by said original subscribers) to the persons and in the manner directed in said Reorganization Plan as amended, said stock to be fully paid and non-assessable;

Be It Further Resolved: That the President and Secretary of this Corporation be and they are hereby authorized and directed to execute and deliver, for and on behalf of this corporation, a trust agreement in words and figures as follows, to-wit:

RESPONDENT'S EXHIBIT G.

Thereupon, motion duly made, seconded and carried, the following resolution was unanimously adopted:

Whereas, pursuant to the Reorganization Plan as amended of Claridge Building Corporation (Claridge Apartments), this corporation is required to assume and agree to pay the unpaid reorganization expenses, the approximate amount of which is \$13,500.00; and

Whereas, the Claridge Apartments are subject to delinquent taxes, the approximate amount of which, including estimated taxes for the first half of 1934 is \$13,000.00; and

Whereas, from the funds available and about to become available from the operation of the property approximately \$8,000.00 can be applied on account of the payment of the unpaid reorganization expenses and taxes, so that a sum of approximately \$18,500.00 is required to provide for the payment of the balance of such unpaid reorganization expenses and taxes; and

Whereas, in the opinion of the Board of Directors it is advisable to provide for the payment of delinquent taxes, so that a saving can be effected in the interest and penalties due thereon, for the establishment of a reserve for the payment of the first half of the 1934 taxes and for the payment of the unpaid reorganization expenses and to borrow such amount of funds as is necessary therefore; and

Whereas, a commitment has been procured for a loan in an amount not to exceed \$18,500.00, to be secured by a first mortgage on the property of this corporation executed by this corporation, to bear interest at the rate of 5% per annum, to mature in seven and one-half years, with the privilege of pre-payment in this corporation of all or any part of the loan on any interest payment date upon payment of a premium of 2% for the first two years, but no premium thereafter, at a commission charge of 1½% on the amount loaned, plus \$75.00 to cover attorneys' fees of the lender; the net proceeds of which loan will be used to pay the unpaid reorganization expenses and taxes, including the establishment of a reserve for the payment of the first half of the 1934 taxes; and

Whereas, the terms of such proposed loan have been approved by the United States District Court, which confirmed the Reorganization Plan as amended, and in the opinion of the Board of Directors of this corporation are unusually fair;

Now, Therefore, Be It Resolved: That the Board of Directors of this Corporation recommend such first mortgage and direct the submission of the execution and delivery thereof to a vote at a Special Meeting of Shareholders of this corporation, to be held on the 9th day of September, 1935, at the hour of 11:00 o'clock A. M.

Be It Further Resolved: That upon the authorization of such mortgage by the shareholders, the proper officers of this corporation be, and they are hereby authorized and directed, in behalf of this corporation, to execute a note or notes of this corporation to evidence the loan, and to execute and deliver a first mortgage or trust deed of this corporation to secure same, said mortgage or trust deed to convey the following described property of this corporation:

Lots one hundred nine (109), one hundred ten (110), one hundred eleven (111) and one hundred twelve (112) of Sheridan Drive Subdivision of the North Three-quarters (N¼) of the East Half (E½) of the Northwest Quarter

(NW 1) of Section seventeen (17), Township Forty (40) North, Range fourteen (14), East of the Third Principal Meridian together with that part of the West Half (W 1/2) of the Northwest Quarter (NW 1/4) of said Section which lies North of the South eight hundred (800) feet thereof and East of Green Bay Road, in Cook County, Illinois.

141 such note or notes and such mortgage or trust deed to contain such terms and provisions, not inconsistent with these resolutions, as said officers shall, in their discretion, determine, and to execute all other papers and documents and do all things necessary or desirable to consummate said loan and to apply the net proceeds thereof towards the payment of the unpaid reorganization expenses and taxes, including the establishment of a reserve for the payment of the first half of the 1934 taxes.

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RESPONDENT'S EXHIBIT H.

Whereas, pursuant to the Reorganization Plan as amended of Claridge Building Corporation, this corporation is required to assume and agree to pay the unpaid reorganization expenses, the approximate amount of which is \$13,500.00; and

Whereas, the Claridge Apartments are subject to delinquent taxes, the approximate amount of which, including estimated taxes for the first half of 1934, is \$13,000.00; and

Whereas, from the funds available and about to become available from the operation of the property approximately \$8,000.00 can be applied on account of the payment of the unpaid reorganization expenses and taxes, so that a sum of approximately \$18,500.00 is required to provide for the payment of the balance of such unpaid reorganization expenses and taxes; and

Whereas, in the opinion of the shareholders it is advisable to provide for the payment of delinquent taxes, so that a saving can be effected in the interest and penalties due thereon, for the establishment of a reserve for the payment of the first half of the 1934 taxes and for the payment of the unpaid reorganization expenses and to borrow such amount of funds as is necessary therefore; and

Whereas, a commitment has been procured for a loan in an amount not to exceed \$18,500.00, to be secured by a

first mortgage on the property of this corporation executed by this corporation, to bear interest at the rate of 5% per annum, to mature in seven and one-half years, with the privilege of pre-payment in this corporation of all or any part of the loan on any interest payment date upon payment of a premium 2% for the first two years, but no premium thereafter, at a commission charge of $1\frac{1}{2}\%$ on the amount loaned, plus \$75.00 to cover attorneys' fees of the lender; the net proceeds of which loan will be used to pay the unpaid reorganization expenses and taxes, including the establishment of a reserve for the payment of the first half of the 1934 taxes; and

Whereas, the terms of such proposed loan have been approved by the United States District Court, which confirmed the Reorganization Plan as amended, and in the opinion of the shareholders of this corporation are unusually fair;

Now, Therefore, Be It Resolved: That the proper officers of this corporation be, and they are hereby authorized and directed, in behalf of this corporation, to execute a note or notes of this corporation to evidence the loan, and to execute and deliver a first mortgage or trust deed of this corporation to secure same, said mortgage or trust deed to convey the following described property of this corporation:

Lots one hundred nine (109), one hundred ten (110), one hundred eleven (111) and one hundred twelve (112) of Sheridan Drive Subdivision of the North three-quarters (3) of the East Half ($E\frac{1}{2}$) of the Northwest Quarter ($NW\frac{1}{4}$) of Section seventeen (17), Township Forty (40) North, Range fourteen (14), East of the Third Principal Meridian, together with that part of the West Half ($W\frac{1}{2}$) of the Northwest Quarter ($NW\frac{1}{4}$) of said Section which lies North of the South eight hundred (800) feet thereof and East of Green Bay Road, in Cook County, Illinois;

such note or notes and such mortgage or trust deed to contain such terms and provisions, not inconsistent with these resolutions, as said officers shall, in their discretion, determine, and to execute all other papers and

documents and do all things necessary or desirable to consummate said loan and to apply the net proceeds thereof towards the payment of the unpaid reorganization expenses and taxes, including the establishment of a reserve for the payment of the first half of the 1934 taxes.

The Chairman thereupon read to the shareholders the minutes of the Special Meeting of the Board of Directors of this corporation held on July 1, 1935, at the hour of 10:00 o'clock A. M., and presented the Reorganization Plan as amended and order confirming and approving same, the Trust Agreement, the Indemnification Agreements and the Management Contract attached to said minutes. The minutes and documents attached thereto were examined and considered, and on motion duly made, seconded and carried, the following resolution was unanimously adopted:

Resolved: That all action of the Board of Directors of this corporation taken at their meeting held on July 1, 1935, at the hour of 10:00 o'clock A. M., as evidenced by the minutes of said meeting, be and the same is hereby ratified, approved and confirmed in all respects.

There being no further business, the meeting thereupon adjourned.

(signed) M. C. Kuehn,
Chairman.

(signed) James Webber,
Acting Secretary.

RESPONDENT'S EXHIBIT I.

IN THE DISTRICT COURT OF THE UNITED STATES.

(Caption—56230)

FINAL DECREE.

This cause coming on to be heard upon the motion of the Debtor and of George W. Rossetter, Jay C. McCord and Sidney H. Kahn, constituting the Claridge Apartments First Mortgage Bondholders' Committee, pursuant to a deposit agreement dated September 9, 1931, therein after referred to as the "committee") for the entry of a decree herein finally closing this proceeding, and the Court, having been fully advised concerning the proceedings heretofore had and taken herein and having heard the statements of counsel for the committee, and upon due notice to all attorneys of record, and the court being fully advised in the premises, finds:

That on May 14, 1935, an order was entered herein con-

firming and approving the plan of reorganization filed by the debtor decreeing the same to be in full force and effect.

And it further appearing to the Court that said plan of reorganization has now been fully and completely executed, carried out, and accomplished and that the new securities called for by said plan of reorganization have either been distributed to the persons entitled thereto or are available to such persons.

And it further appearing to the Court that all acts and proceedings of the Debtor in this cause have been pursuant to and in conformity with the requirements of Section 77-B of an Act of Congress, entitled "An Act to Establish a Uniform System of Bankruptcy Throughout the United States and Acts Amendatory and Supplemental Thereto."

145 It is therefore ordered, adjudged, and decreed.

1. The plan of reorganization therefore confirmed by this Court is hereby declared to be in all respects fully executed, carried out, and accomplished.

2. The action of Edmund D. Adcock as Special Master, in releasing the trust deed and chattel mortgage from Claridge Building Corporation to Melvin L. Straus, Trustee, dated March 25, 1924, and recorded in the office of the Recorder of Deeds of Cook County, Illinois, as document 8340617, should be and the same is hereby approved and ratified in all respects.

3. The Acts and doings of the Debtor, the Committee, and the other parties named therein, in executing the various agreements and documents provided for in said plan of reorganization and approved by the Court be and the same are hereby approved in all respects.

4. That all the first mortgage bonds in the principal amount of \$277,000.00 and interest coupons thereto attached, secured by trust deed and chattel mortgage to Melvin L. Straus, dated March 25, 1924, recorded in the office of the Recorder of Deeds of Cook County, Illinois, as document No. 8340617 and said trust deed and chattel mortgage, are hereby declared to be of no further force and effect as against the Debtor or its property, and the holders thereof shall be entitled to receive only the new securities provided for in said plan of reorganization, and all holders, pledgees, and owners of bonds and interest coupons secured by said first mortgage trust deed and

chattel mortgage, and Melvin L. Straus, Trustee thereunder, shall be and they are hereby forever jointly and severally enjoined from commencing and or prosecuting any proceedings of any nature whatsoever against the Debtor, its grantees successor or assigns, or against any of the property of the Debtor on any of said first mortgage bonds or interest coupons and all creditors and stock holders of the Debtor, secured and unsecured, are hereby forever enjoined and restrained from taking or continuing any action, steps or proceedings or bringing or continuing

any suit or action at law, in equity, or otherwise, against the Debtor or its property for, on account of, or by reason of any claim, matter, judgment, or thing, excepting only such liabilities and claims which the Debtor has expressly assumed or agreed to pay pursuant to the terms and provisions of the said plan of reorganization.

5. Melvin L. Straus, as Trustee, complainant in the suit entitled "Melvin L. Straus, Trustee, vs. Claridge Building Corporation, et al.," Case No. 544125, Superior Court of Cook County, and all other persons, be, and they are permanently restrained and enjoined from taking any further action in connection with said proceedings.

6. Said Debtor, Claridge Building Corporation, should be and it is hereby discharged from all its debts, claims and liabilities existing on June 16, 1934, the date of the filing of the petition herein.

7. The proceedings in this Court entitled "In the Matter of Claridge Building Corporation, a corporation, Debtor", Case No. 655125, be and the same are terminated and finally closed.

Enter:

Philip W. Sullivan,
Judge.

Chicago, Illinois,
3 1 37.

147 . THE TAX COURT OF THE UNITED STATES.

Filed
Dec. 4,
1942.

Claridge Apartments Company, an Illinois Corporation,
Petitioner, vs. Commissioner of Internal Revenue, Re-
spondent.

Docket No. 106868. Promulgated December 4, 1942.

1. Neither expenses incident to 77B reorganization assumed by transferee nor nominal stock interest in reorganized company accorded to stockholders of predecessor *held* to disqualify transaction as a "reorganization" under Revenue Act of 1934, section 112. *Held*, *reversing v. Southwest Consolidated Corporation*, 315 U. S. 194, distinguished. *Held, further*, on facts exchange of property was solely for petitioner's stock.

2. Provisions of the Chandler Act relating to taxation of income resulting from reduction of indebtedness in reorganizations, *held* applicable to the entire calendar year 1938, and to interest forgiven, but *held, further*, not applicable in the case of substitution of common stock for outstanding principal of bonds.

Walter Hamilton, Esq., for the petitioner.

David Altman, Esq., and George E. Gibson, Esq., for the respondent.

By this proceeding petitioner charges that respondent erred in determining deficiencies in the amounts and for the years indicated as follows:

Year	Income tax	Excess profits' tax
1935	\$844.39	\$57.05
1936	706.92
1937	752.76
1938	985.67	10.80

The contested issues relate to petitioner's basis for depreciation of its apartment house property and deduction of items for painting and repairing.

Findings of Fact.

Petitioner is a corporation, organized May 28, 1935, under the laws of the State of Illinois pursuant to a proceeding under 77B of the National Bankruptcy Act. It filed its income and excess profits tax returns for the years 1935 to 1938, inclusive, with the collector of internal revenue for the first district of Illinois.

148 The Claridge Building Corporation, also an Illinois corporation, and hereinafter for convenience referred to as the Building Corporation, acquired the lot at 4501 Malden Street, Chicago, Illinois, from Charles F. Henry in 1924. The acquisition was pursuant to a contract whereby the Building Corporation agreed to issue and did issue its entire authorized capital stock to Charles F. Henry in consideration of the transfer of the lot by Henry. During the spring and summer of 1924 the Building Corporation caused an apartment building to be erected on the lot at a cost of \$385,326.37. By August 1, 1935, \$139,253.71 depreciation had been taken on a "cost" of \$424,609.19 which included a contractor's commission to Henry.

Up to 1932 the stock of the Building Corporation, with the exception of two qualifying shares, was owned by Charles F. Henry. In 1932 and thereafter it was stated to be held as follows: Minnie H. Case, sister of Charles F. Henry, 198 shares; Howard D. Henry and Albert A. Henry, brothers of Charles F. Henry, one share each.

On March 25, 1924, the Building Corporation issued its 64 per cent first mortgage bonds in the principal amount of \$340,000. The bond issue was secured by trust deed and chattel mortgage covering the property located at 4501 Malden Street, executed March 25, 1924, to Melvin L. Straus, as trustee. On October 1, 1931, the bonds were outstanding and unpaid in the principal amount of \$277,000. Defaults having therefore occurred in the payments of principal and interest, the trustee filed a bill of foreclosure on October 1, 1931, and all of the bonds were declared immediately due and payable. A decree of foreclosure was entered on February 19, 1932, but there was no sale of the mortgaged property under the decree and the foreclosure proceeding was never consummated. The trustee took possession of the property and collected the rents after October 1, 1931.

On September 9, 1931, a bondholders' committee was

organized under a deposit agreement of that date with the American National Bank & Trust Co. of Chicago. As of November 27, 1934, the committee had on deposit with the bank \$258,600 of the bonds, or approximately 93 per cent of the total amount of the bonds outstanding.

On June 16, 1934, the Building Corporation filed a voluntary petition in the District Court of the United States for the Northern District of Illinois, Eastern Division, under section 77B of the National Bankruptcy Act as amended.

On November 27, 1934, the bondholders' committee, the Building Corporation, and Minnie H. Case agreed on a reorganization plan. The plan recited that Minnie H. Case was the record holder of the title to the property in question, but that she held title for the benefit of the 140 Building Corporation, and that she owned the furnishings of some of the apartments.

The plan provided, *inter alia*, as follows:

1—A new corporation shall be organized under the laws of the State of Illinois with an authorized capital stock consisting of 3,080 shares of common stock without par value, or with such par value as may be agreed upon by the parties hereto. Upon completion of the reorganization, Minnie H. Case shall convey title to the property to said new corporation and the [Building] corporation shall execute a confirmatory quitclaim deed to the new corporation. 2,776 shares of the common stock of the new corporation shall be issued to three Trustees to be selected by the Committee, subject to the approval of the court. Trust certificates shall be issued to the holders of the first mortgage bonds and each first mortgage bondholder shall receive a trust certificate representing one share of stock for each \$100.00 in face amount of bonds owned by him. The stock so issued to said Trustees shall constitute 90% of the outstanding stock of the new corporation. 10% of the outstanding stock of the new corporation shall be issued to or upon the order of the Owner [the stockholders of the Building corporation].

4—The new corporation shall by written agreement indemnify the present Trustee under the bond issue against any and all liability which he may suffer or incur by reason of his operation of the property (other

than for wrongful acts of the Trustee) and against any and all taxes, assessments or other governmental charges which may be levied or assessed against him covering the period of his possession of the property. The new corporation shall also by written agreement indemnify the Committee against any and all taxes, assessments or other governmental charges which may be levied or assessed against it and against any and all liability which may be suffered or incurred by the Committee by virtue of the reorganization plan, including the expenses and reasonable attorneys' fees in the event that litigation is instituted against the Committee or any member thereof.

The new corporation shall assume and agree to pay the reorganization expenses hereinafter referred to and these expenses shall be paid in full before any dividends shall be declared or paid upon the stock of the new corporation. Subject to the approval of the court, the following reorganization expenses shall be allowed:

(a) To cover the general expenses and compensation of the Committee including the charge of Securities Service Corporation, 1% of the face amount of deposited bonds plus out of pocket expenses;

(b) Charge of the Depositary on the basis of three fourths of 1% of the face amount of deposited bonds plus out of pocket expenses;

(c) Compensation of counsel for the Committee;

(d) Compensation of counsel for the owner.

In addition there shall be allowed the expenses and charges in the foreclosure proceeding, including the Trustee's fee, the fee of Trustee's counsel, court costs and Master's fees. There shall also be allowed and paid the actual expenses to be incurred in connection with the organization of a new corporation, printing of the trust agreement and the new securities, stamp taxes, title guaranty expense, court costs in the bankruptcy proceeding and other similar items.

150 Upon consummation of the reorganization, the present Trustee shall surrender possession to the new corporation and all net assets of the Trustee over and above the liabilities of the Trustee in connection with the operation of the property shall be applied toward the payment of the reorganization expenses.

The plan also provided that Minnie H. Case was to execute and deliver to the new corporation a bill of sale covering all of the personal property owned by her which was located in the apartments, for which she should be paid the sum of \$1,400. The new corporation was to enter into a management contract with Minnie H. Case and she was to be one of the three directors of the new corporation. The plan, after amendment not material here, was confirmed and approved by the court in an order dated May 14, 1935.

The court order provided for the release of the trust deed and chattel mortgage of March 25, 1924, and stated that the bonds and interest coupons were satisfied and of no further force and effect and authorized the issuance of the new securities.

The final decree in the 77B proceeding entered March 1, 1937, provided in part as follows:

1: The plan of reorganization theretofore confirmed by this court is hereby declared to be in all respects fully executed, carried out and accomplished.

4: That all of the first mortgage bonds in the principal amount of \$277,000.00 and interest coupons thereto attached, secured by trust deed and chattel mortgage to Melvin L. Straus, dated March 25, 1924, recorded in the office of the Recorder of Deeds of Cook County, Illinois, as document No. 8340617, and said trust deed and chattel mortgage, are hereby declared to be of no further force and effect as against the Debtor or its property, and the holders thereof shall be entitled to receive only the new securities provided for in said plan of reorganization, and all holders, pledgees and owners of bonds and interest coupons secured by said first mortgage trust deed and chattel mortgage, and Melvin L. Straus, Trustee, thereunder, shall be and they are hereby forever jointly and severally enjoined from commencing and or prosecuting any proceedings of any nature whatsoever against the Debtor, its grantees, successors or assigns, or against any of the property of the Debtor on any of said first mortgage bonds or interest coupons, and all creditors and stockholders of the Debtor, secured and unsecured, are hereby forever enjoined and restrained from taking or continuing any action, steps or proceedings or bringing or continuing any suit or action at law, in

equity or otherwise against the Debtor or its property for, on account of, or by reason of any claim, matter, judgment or thing, excepting only such liabilities and claims which the Debtor has expressly assumed or agreed to pay pursuant to the terms and provisions of said plan of reorganization.

5: Melvin L. Straus, as trustee, complainant in the suit entitled "Melvin L. Straus, trustee, vs. Claridge Building Corporation, et al.," case No. 544125, Superior Court of Cook County, and all other persons be and they hereby are permanently restrained and enjoined from taking any further action in connection with said proceedings.

151 Pursuant to the plan petitioner was organized and the property transferred to it. Minnie H. Case also transferred the furniture which she owned in the apartment building to petitioner.

As of August 1, 1935, there were delinquent taxes outstanding of \$13,000. The reorganization expenses amounted to approximately \$13,500. The trustee had approximately \$8,000 on hand.

Expenses of the foreclosure proceeding in the state court were as follows:

Master's fee	\$1,250.00
Trustee's fee	1,050.98
Attorneys for trustee	2,970.98
	<hr/>
	\$5,271.96

Minutes of petitioner's board of directors meeting of August 7, 1935, recited as follows:

Whereas, pursuant to the Reorganization Plan as amended of Claridge Building Corporation (Claridge Apartments), this corporation is required to assume and agree to pay the unpaid reorganization expenses, the approximate amount of which is \$13,500.00; and

Whereas, the Claridge Apartments are subject to delinquent taxes, the approximate amount of which, including estimated taxes for the first half of 1934, is \$13,000.00; and

Whereas, from the funds available and about to become available from the operation of the property approximately \$8,000.00 can be applied on account of the payment of the unpaid reorganization expenses and

taxes, so that a sum of approximately \$18,500.00 is required to provide for the payment of the balance of such unpaid reorganization expenses and taxes.

On a reference of the matter to the stockholders similar recitals were made in the minutes of their meeting held September 9, 1935.

In order to meet these obligations it was necessary for petitioner to borrow \$18,500. A loan in this amount secured by a mortgage on the property was obtained by petitioner and approved by the court on July 26, 1935.

The reorganization expenses in the approximate total amount of \$13,500 were paid by petitioner in the latter part of 1935 or the early part of 1936.

The certificates of deposit which were issued by the bondholders' committee were traded in as an over the counter security in Chicago during the year 1935 at a market price ranging from \$190 to \$207.50 for a certificate representing a \$1,000 bond. In December of 1935, after most of the petitioner's stock had been issued, the market price for certificates of deposit not yet turned in for petitioner's stock was \$190 per thousand dollar certificate of deposit. The market for securities of Chicago real estate corporations, organized or in the process of being reorganized, was poor during the year 1935.

152. Under the plan the petitioner's stock was issued at the rate of one share per \$100 face value of bonds of the old company. The fair market value of petitioner's stock never exceeded \$45 per share at any time during the year 1935.

Petitioner's capital stock consisted of 3,080 shares of common stock without par value. On September 5, 1935, 2,770 shares were issued to certain nondepositing bondholders and to voting trustees for the depositing bondholders to whom were issued trust certificates, each certificate representing one share of stock. Three hundred and eight shares of petitioner's stock were issued to the old stockholders, Minnie H. Case receiving 300 shares and Charles F. Henry 8 shares. Two shares remained unissued.

The building at 4501 Malden Street is a three story and basement court type apartment building with a large terrazzo floored lobby from which stairways lead up to the various groups of apartments. It contains 106 apartment

There are eighty 2 1/2-room apartments (living room, in-a-door bed, large dressing closet, dinette, kitchen, and bath) and twenty-six 3 1/2-room apartments (extra bedroom). The first story of the building is fireproof and the other two stories are brick and frame, with brick walls surrounding each apartment unit. Pressed brick was used on the street fronts and courts. Each apartment has a refrigerator, gas range, tall china cabinet and linen case, a full size door mirror, vitreous china lavatory and toilet, and a bay window. The building has two large Kewanee boilers (one of which gives sufficient service), six laundries, intercommunicating telephone system, Government approved mail boxes, push bells and speaking tubes, carpeted stairs and hall, and best grade clear oak floors.

The property in question, including the apartment building and furnishings and the lot on which situated, was sold in July 1940, for \$126,200, plus an assumption of about \$20,000 of liabilities. The market in 1940 was much higher and more active than in 1935.

The fair market value of the apartment building located at 4501 Malden Street, Chicago, exclusive of the land as of May 14, 1935 (the date on which the court confirmed the plan) was not in excess of \$141,000. The fair market value of the land on that date was \$16,000.

The adjusted basis of petitioner's predecessor in 1935 was \$229,377.33.

At the date of acquisition by petitioner the building had a remaining useful life of 25 years.

Petitioner reported its income and deductions on an accrual system of accounting. Under the system of accounting used by petitioner it deducted on its returns all expenses for painting and decorating and repairs in the year in which such expenses were paid. On its 1936 return petitioner included its expense deductions an amount of \$1,219.44 expended in that year for painting and decorating and \$389.60 expended in that year for repairs. These identical items were deducted for a second time in petitioner's 1937 return, and for that reason were disallowed by respondent for that year.

OPINION.

OPPER, J.: The first point in controversy is the correct basis for depreciation on petitioner's property, the problem being whether that is cost to petitioner or its predecessor's adjusted basis. The primary question is whether under Revenue Act of 1934, section 112, and particularly under the recent decisions of the Supreme Court¹ interpreting it, there was a reorganization when, in a 77B proceeding, petitioner's predecessor transferred to it its only asset, a building called the Claridge Apartments, in exchange for the issuance to the predecessor's creditors of 90 percent, and to its stockholders of 10 percent of petitioner's stock.

Whatever doubt there may have been that creditors of an insolvent predecessor corporation can furnish the continuity of proprietary interest necessary to a technical reorganization, has recently been dispelled. *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U. S. 179; *Palm Springs Holding Corporation v. Commissioner*, 315 U. S. 185. Nor are we by any means satisfied of the correctness of respondent's assertion that *Helvering v. Southwest Consolidated Corporation*, 315 U. S. 194, determines the present issue in his favor. It is true that that case emphasizes the requirement of the 1934 Act that to constitute a reorganization the transfer of property must be solely in exchange for the transferor's voting stock, and holds that even an indirect payment partly in cash defeats the attempt to apply it.

But effect is given, of course, to the retroactive amendment of 1939 removing from consideration the assumption of a transferor's indebtedness or acceptance of property subject to it; and the Court is at pains to point out that the transferee in the *Southwest Consolidated* case did more than this when it undertook under the plan to repay cash which had been borrowed to satisfy nonassenting creditors. "But in substance," it remarks, "the transaction was precisely the same as if respondent [the taxpayer] had paid cash plus voting stock for the properties. . . . part of the consideration which respondent paid for

¹ *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U. S. 179; *Palm Springs Holding Corporation v. Commissioner*, 315 U. S. 185; *Rothhold v. Commissioner*, *Marlborough Investment Co. v. Commissioner*, 315 U. S. 189; *Helvering v. Southwest Consolidated Corporation*, 315 U. S. 194.

the properties of its predecessor was cash in the amount of about \$106,680. The fact that it was paid to the bank 154 rather than to the old corporation or its creditors is immaterial. The requirement to pay cash arose out of the reorganization itself. It derived, as did the requirement to pay stock, from the plan pursuant to which the properties were acquired. . . .

Here the only payments of cash contemplated by the plan were for past-due taxes on the property, expenses of an abortive foreclosure action previously instituted against it, and costs and disbursements of the 77B proceeding itself. Respondent's brief concedes that "the delinquent realty taxes, fees paid to the counsel for the debtor corporation, and possibly fees paid in connection with foreclosure proceedings brought by the indenture trustee, . . . quite possibly (had petitioner offered and introduced the proof relating thereto) might have been shown to represent liabilities of the old debtor company."

We can not conceive that the only remaining item, the expense connected with the reorganization itself, including fees and disbursements to the bondholders' committee and its depository, court costs, and payments for printing and for the organization of petitioner can be of the character to which the Supreme Court referred when it excluded items of which the "nature and amount" were determined and fixed in the reorganization. Such payments did not, like those in the *Southwest Consolidated* case, go indirectly to the old corporation or its creditors. True, in a general sense they constituted part of the cost paid by petitioner for the property received. But they were of a nature characteristic of all reorganizations of this kind, and normally there is no source of payment for them save the new corporation or its property. If they are fatal here, then it is difficult to envision any plan growing out of an equity or 77B receivership which would qualify under section 112. We can not believe such a result was intended.

But, however that may be, we think petitioner has shown enough here to sustain its contention that nothing was paid except liabilities of the predecessor or its property. In Illinois real estate taxes are imposed, if not on the owner, at least on the land and building. *Edward C. Kall-sant*, 40 B. T. A. 528, 535; *Pyramid Metals Co.*, 44 B. T. A. 1087, 1088—upon which they constitute a lien. These

amounted to \$13,000. The foreclosure proceedings likewise set up a liability for costs and expenses to which any conveyance of the property would presumably be subject. *Benton State Bank v. Bennett*, 249 Ill. App. 539; *Christensen v. Niebert*, 259 Ill. App. 96; *Chicago Trust Co. v. 12-14 West Washington St. Building Corporation*, 278 Ill. App. 117. These amounted to \$5,270.98. In addition, the cash in the hands of the trustee for the old company was committed to payment of expenses to its full extent, namely \$8,000.

155 There was thus a total of \$26,270.98 which must be regarded either as indebtedness of the transferor assumed by the transferee or as a charge against the transferred property within the express terms of the 1939 amendment. The small balance of \$229.02 is not only negligible under the circumstances, but we may take notice that it could reasonably have covered only such items as cost of petitioner's incorporation, stamp taxes, printing bills and the like, which were clearly no part of any payment by the transferee to the transferor "in exchange" for the transfer of the property. In the premises we are unwilling to say that petitioner has failed to sustain its burden of showing the necessary facts to invoke the provisions of section 112.

Respondent suggests that this fell short of a tax free reorganization for the additional reason that, while the creditors received 90 percent of petitioner's stock, indicating that they had acquired effective ownership of the predecessor, the stockholders were given a 10-percent interest, which demonstrated that the creditors had not succeeded to an exclusive interest. It is urged, which is the fact, that no such situation existed in the cases recently decided by the Supreme Court.

We think, however, that this is a distinction without a difference. In the first place, if it were possible to imagine a set of circumstances where a corporation was insolvent to the extent that a 90 percent proprietary interest had accrued to its creditors but 10 percent was left in its former stockholders, no reason is apparent why the statutory language would not apply to a plan which gave effect to that division of ownership. The preservation of proprietary interests would be respected quite as much there as in, say, *Helvering v. Southwest Consolidated Corporation*, *supra*. The bondholders here "acquired substantially the entire proprietary interest of the old stockholders."

But in any event, the insolvency of the transferor in the present case is inescapable. There can be no question but that in fact and in law the creditors were in exclusive control. If the plan was improper and subject to disapproval upon the bondholders' objection, see *Northern Pacific Railway Co. v. Bond*, 358 U.S. 482, that would not make it any the less a plan of reorganization upon acceptance by the necessary percentage of bondholders and confirmation by the court, although it might fail to qualify as an "exchange" under 112 (b) (5). See *Helvering v. Cement Manufacturers, Inc.*, U.S. (June 1, 1942). What reason there may have been for the voluntary recognition of the old stockholders to the extent of a nominal share in the new enterprise does not appear. It may well have been a desire not to be ungenerous, or, more likely, a selfish hope that their pecuniary interest would encourage the former shareholders to more effective efforts under the management agreement. Certainly we need not view it as a concession that they retained any equity when the facts deny that possibility. It follows that, as far as the reorganization question goes, petitioner was entitled to the original basis.

Apart from this, however, respondent insists that the provisions of the so-called "Chandler Act,"² particularly

2. Public No. 696, 70th Cong., 52 Stat. 840, as amended:

"Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter, by reason of a modification in or cancellation in whole or in part of any of the indebtedness of the debtor, in a proceeding under this chapter.

"Sec. 269. Where it appears that a plan has for one of its principal purposes the avoidance of taxes, objection to its confirmation may be made on that ground by the Secretary of the Treasury, or, in the case of a State, by the corresponding official or other person so authorized. Such objections shall be heard and determined by the judge, independently of other objections which may be made to the confirmation of the plan, and, if the judge shall be satisfied that such purpose exists, he shall refuse to confirm the plan.

"Sec. 270. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under

section 270, as amended, require that petitioner's basis be reduced to the fair market value of the property when petitioner received it, but he concedes that under *The Commodore, Inc.*, 46 B. T. A. 718, no year earlier than 1938 would be affected.

157. That the provision does apply to the petitioner's 1938 tax liability, however, seems to us not subject to serious doubt. The act was made effective September 22, 1938, before the end of the petitioner's 1938 tax year, and long before its return for that year became due. The reasons advanced in *The Commodore, Inc.*, *supra*, including reference to the legislative history, are hence inappropriate. The "future" liability to which the Committee referred was evidently an apt description of the present situation, since the end of the year as of which the tax was to be computed and the date when the first installment would become due both lay ahead when the act became effective.

While not strictly a revenue act, the legislation by its terms dealt with taxes, and can be assumed to have en-

tered this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section.

"Sec. 276. c. the provisions of sections 77A and 77B of chapter VIII, as amended, of the Act entitled 'An Act to establish a uniform system of bankruptcy throughout the United States', approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes; and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient."

visaged like principles as to periods to which it would apply. It is now so familiar as to be virtually traditional that revenue acts cover calendar years during which they take effect. See *United States v. Hudson*, 299 U. S. 498. In fact, it possibly requires express language to avoid application even to earlier periods. Cf., e.g., Revenue Act of 1938, secs. 1 and 903. And our system of administering income tax computation on an annual basis makes impractical such suggestions as petitioner's that if relevant at all the Chandler Act should be construed to fix depreciation only for the part of the year remaining after it went into effect.

The question remains, however, whether in this case the "indebtedness" . . . has been canceled or reduced" as described in section 270. Section 268 is an obvious legislative effort to release 77B reorganizations from the tax burden of the *Kirby* case,³ and, since section 270 is manifestly in *pari materia* with it, we have to consider whether this is the sort of situation to which either section was intended to apply. It may advance us little to grant that in the meantime some courts have devised a formula for lifting certain types of debt adjustment out of the *Kirby* rule. E.g., *Hirsch v. Commissioner* (C. C. A., 7th Cir.), 115 Fed. (2d) 656. But cf. *Frank v. United States* (U. S. Dist. Ct., E. Dist. Pa.), 44 Fed. Supp. 729. For the theory of that limited group of cases is that the property for the purchase of which the debt was incurred has so declined in value that the cancellation may be regarded as no more than a retrospective readjustment of the original purchase price. That being so, there is no reason to grant the owner a deduction for depreciation computed on a larger base, any more than to permit him to report his ultimate gain or loss on disposition by using the original higher cost. See *Hirsch v. Commissioner*, *supra*.

158. But in another setting, the same result has been reached on a totally different theory. The substitution of common stock for bonds is not a cancellation or reduction of the liability represented by the bonds, no matter how much less the stock may be worth, since the assets are not thereby freed from obligation. While the bond loan has been terminated, the amount borrowed is now committed to capital stock liability in

3. *Kirby Lumber Co. v. United States*, 284 U. S. 1

stead of to the liability of a fixed indebtedness." *Capento Securities Corporation*, 47 B. T. A. 691.

Using this approach, it is evident that there was here no true reduction or cancellation of the original indebtedness, but what amounts to a continuation of it in another form. It follows that neither the language nor the reason for section 270 has any application here. Both gain or loss and depreciation to the new corporation can appropriately be measured by the old basis, without doing violence either to the tax consequences of the reorganization or to the doctrines upon which those consequences rest.

What we have said, however, relates only to the outstanding principal of the bonded debt. The interest was also due, and that it was forgiven rather than transformed into stock appears affirmatively, although its amount is not shown. Adjustment for this item must be made. *Capento Securities Corporation, supra*. True, the statute excludes "accrued interest unpaid" from the write-down of basis on account of forgiveness, but only if "not resulting in a tax benefit on any income tax return." We can not say from the evidence what the facts are in this respect, and accordingly must assume, in respondent's favor, that petitioner's predecessor had obtained a tax benefit as to the entire amount. What that amount should be can, it is to be hoped, be agreed upon by the parties in connection with the computation under Rule 50.

We are not concerned by fears for the constitutionality of such an interpretation in so far as it involves a retroactive application to reorganizations previously completed, like the one before us. The legislative intention to deal with such cases must be accepted. *The Commodore, Inc., supra*. Only the tax liability for the year of enactment is in question. See *United States v. Hudson, supra*. A new basis growing out of a previously completed reorganization may constitutionally be provided. *Schweitzer & Conrad, Inc.*, 41 B. T. A. 533. And in any event, the doctrine of the *Hendler* case⁴ prevented this from being a tax-free reorganization at the time it took place. See *Helvering v. Southwest Consolidated Corporation, supra*. The proper depreciation basis then became petitioner's cost. Only the retroactive amendment of 1939 eliminated the *Hendler* principle and in the meantime the Chandler Act had been

4. *United States v. Hendler*, 303-U. S. 504.

enacted. There was hence no hiatus in petitioner's 159 continuing liability, and the provision, if it can be said to be retroactive at all, certainly made no change in petitioner's position and hence obviously had no unconstitutional effect upon its substantial rights.

This conclusion requires that we find both the predecessor's basis, for the years 1935⁵ through 1937, and the fair market value on confirmation for 1938. The latter is necessary in the event that adjustment for the forgiven interest would otherwise reduce the adjusted basis below that amount. The required figures have been included in our findings of fact. Although petitioner and its predecessor consistently used a higher basis, we have found the one determined by the Commissioner, since the petitioner's witness failed to convince us that any amount was actually paid by the old company for contractor's services, or that the original stock issue in fact covered any more than the land.

In ascertaining fair market value upon confirmation we have given consideration to the highest figure estimated by respondent's expert for the property as a whole, bearing in mind the actual sale in 1940, and the value placed upon the land alone by petitioner's witness, as being most conducive to a computation which is reasonably fair under all the circumstances. This market value may constitute petitioner's basis for 1938, if it develops that it is higher than the original basis reduced by the part of the debt adjustment ratably allocated to the depreciable property in the proportion of original land value to total basis. See Regulations 94, art. 113(b)-2, as amended (1940-2 C. B. 107).

There remains the question of petitioner's claim for deductions of decorating and repair items as business expense for 1937. While the parties are in accord that petitioner's books and tax returns were figured on the "accrual" basis, the explanation given rather resembles a cash or reverse accrual system. The deductions in question were customarily taken in the year payment was made, but they were set up as a sort of reserve running into the following year, not because payment was not due, but apparently on the theory that leases to which they were applicable would return income during that period.

5. Petitioner conceded at the hearing that as owner for only the last five months of 1935 it was entitled to only that proportion of the year's depreciation.

For tax purposes, however, there seems little question that items deducted in one year can not properly be duplicated in the next, and that, whatever the system of accounting, it can not be authorized if it calls for that treatment. Since we are satisfied from the evidence that petitioner is seeking for 1937 a deduction already taken and allowed for the prior year, respondent's disallowance is approved.

Reviewed by the Court.

Decision will be entered under Rule 50.

160 Smith, J., concurring: I agree that the basis for depreciation of petitioner's assets for 1938 is the fair market value of the assets at the date of reorganization. It is stated, however, in the Court's opinion that:

" * * * The substitution of common stock for bonds is not a cancellation or reduction of the liability represented by the bonds, no matter how much less the stock may be worth, since the assets are not thereby freed from obligation. * * * While the bond loan has been terminated, the amount borrowed is now committed to capital stock liability instead of to the liability of a fixed indebtedness." *Capento Securities Corporation*, 47 B. T. A. 691.

I think that this observation is contrary to well recognized principles of law. Where a corporation substitutes shares of stock in exchange for bonds the corporation is freed from indebtedness. A corporation does not owe any debt in respect of its capital stock.

161 THE TAX COURT OF THE UNITED STATES.

(Caption—106868)

Filed
Jan. 4,
1943.

RESPONDENT'S COMPUTATION FOR ENTRY OF
DECISION.

(Filed Jan. 4, 1943.)

The attached proposed computation is submitted, on behalf of the respondent, to The Tax Court of the United States, in compliance with its opinion determining the issues in this proceeding.

This computation is submitted in accordance with the opinion of the Tax Court, without prejudice to the re-

Respondent's Computation.

spondent's right to contest the correctness of the decision entered herein by the Tax Court, pursuant to the statutes in such cases made and provided.

(Signed) J. P. Wenchel,
F. R. S.

J. P. Wenchel,
Chief Counsel, Bureau of
Internal Revenue.

No Objection:

(Signed) Walter Hamilton,
Counsel for Petitioner.

Of Counsel:

F. R. Shearer,
Division Counsel.

David Altman,
George E. Gibson,
Special Attorneys, Bureau of
Internal Revenue.

162 C.TS:CD
MEC:JOA

Statement.

In re: Claridge Apartments Company,
29 South La Salle Street,
Chicago, Illinois.

Docket: #106868

Income and Excess-Profits Tax Liability.

Year	Kind of Tax	Tax Liability	Tax Assessed	Deficiency
1935				
(8 1 '35 to				
12 31 '35)	Income	\$ 599.47	None	\$ 599.47
	Excess-Profits	None	None	None
1936	Income	237.10	None	237.10
1937	Income	282.50	None	282.50
1938	Income	1,247.75	\$363.01	\$884.74
	Excess-Profits	None	None	None
Totals		\$2,366.82	\$363.01	\$2,003.81

The adjustments shown in the attached schedules have been made for decision under Rule 50 in accordance with the opinion of The Tax Court of the United States promulgated December 4, 1942.

163 Claridge Apartments Co.

Year: 1935.

Schedule 1

Net Income

Net income as shown in the deficiency notice dated January 17, 1941	\$6,141.04
Net income adjusted	4,359.75
Adjustment	\$1,781.29

Schedule 2

Explanation of Adjustment

Petitioner is allowed depreciation on building from August 1, 1935 at the rate of 4% on a basis of \$239,377.33, as follows:

$5/12 \times 4\%$ on \$239,377.33 =	\$3,989.62
Amount previously allowed	2,208.33
Additional deduction allowed	\$1,781.29

Respondent's Computation.

Schedule 3

Computation of Tax

Income Tax

Net income, Schedule 1	\$4,359.75
Less: Interest on Liberty Bonds, etc.	None
Balance subject to income tax	\$4,359.75
Income tax at 13 1/2%	\$ 599.47
Income tax assessed:	
Original, account #864084	None
Deficiency in income tax	\$ 599.47

Excess-Profits Tax

Net income, Schedule 1	\$4,359.75
Less: 12 1/2% of \$40,000.00, declared value of capital stock for year ended June 30, 1935	5,000.00
Balance subject to excess-profits tax	None
Excess-profits tax liability	None
Excess-profits tax assessed:	
Original, account #864084	None
Deficiency	None

Respondent's Computation.

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164 Claridge Apartments Co.

Year: 1936.

Schedule 4

Net Income

Net income as shown in the deficiency notice dated January 17, 1941	\$6,971.96
Net income adjusted	2,700.87
Adjustment	<u>\$4,271.09</u>
Deduction:	
(a) Depreciation	\$4,275.09
Addition:	
(b) Accrued capital stock tax liability	<u>4.00</u>
Net adjustment	\$4,271.09

Schedule 5

Explanation of Adjustment

(a) An additional deduction for depreciation is allowed in the amount of \$4,275.09, computed as follows:

Depreciation on building: 4% of \$239,377.33	\$9,575.09
Depreciation previously allowed	<u>5,300.00</u>
Additional amount allowed	\$4,275.09

(b) The deduction previously allowed for accrued capital stock tax liability has been decreased by \$4.00, computed as shown below:

Adjusted declared value of capital stock for the year ended June 30, 1937 as shown in the deficiency notice dated January 17, 1941	\$192,351.46
Deduct: Decrease in 1936 net income	<u>4,271.09</u>

Adjusted declared value	\$188,080.37
Capital stock tax liability accruable	<u>188.00</u>
Deduction previously allowed	192.00

Overstatement	\$ 4.00
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Respondent's Computation.

Schedule 6

Computation of Tax

Income Tax

Normal Tax

Net income, Schedule 4	\$2,700.87
Less: Excess-profits tax	None
Net income for normal tax computation	\$2,700.87

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Normal Tax Computation

Normal tax on \$2,000.00 at 8%	\$ 160.00
Normal tax on \$700.87 at 11%	77.10
Total normal tax	\$ 237.10

Surtax on Undistributed Profits

Net income, Schedule 1	\$2,700.87
Less: Normal tax	237.10

Adjusted net income	\$2,463.77
Less: Dividends paid credit	2,463.77

Undistributed net income	None
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Surtax liability	None
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Income tax liability	\$ 237.10
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Income tax assessed:	
Original account = \$633.22	None

Deficiency in income tax	\$ 237.10
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Year: 1937.

Schedule 7

Net Income

Net income as shown in the deficiency notice dated January 17, 1941	\$7,388.00
Net income adjusted	3,113.60
Adjustment	\$4,275.00

Respondent's Computation.

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Schedule 8

Explanation of Adjustment

An additional deduction for depreciation is allowed in the amount of \$4,275.09, computed as follows:

Depreciation allowable on building, 4% of \$239,377.33	\$9,575.09
Amount previously allowed	5,300.00
Additional deduction	<u>\$4,275.09</u>

166 Claridge Apartments Co.

Year: 1937.

Schedule 9

Computation of Tax

Income Tax

Normal Tax

Net income, Schedule 7	\$3,113.60
Less: Excess-profits tax	None
Net income for normal tax computation	\$3,113.60
Tax on \$2,000.00 at 8%	\$ 160.00
Tax on \$1,113.60	122.50
Total normal tax	<u>\$ 282.50</u>

Surtax on Undistributed Profits

Net income, Schedule 7	\$3,113.60
Less: Excess-profits tax	None
Normal tax	<u>\$282.50</u>
Adjusted net income	\$2,831.10
Less: Dividend paid credit	<u>2,831.10</u>
Net income subject to surtax	None
Surtax liability	None
Income tax liability	<u>\$ 282.50</u>
Income tax assessed:	
Original, account = \$508.94	<u>None</u>
Deficiency in income tax	<u>\$ 282.50</u>

Respondent's Computation.

Schedule 10

Year: 1938

Net Income

Net income as shown in the deficiency notice dated January 17, 1941

Net income adjusted \$ 10,179.92

9,448.24

Adjustment

\$ 731.68

Schedule 11

Explanation of Adjustments

An additional deduction for depreciation is allowed in the amount of \$731.68, computed as follows:

167 Predecessor's adjusted basis for depreciation of building as of August 1, 1935 \$239,377.33

Less: Depreciation, 8-1-35 to 12-31-37 inclusive

1935	\$3,989.62
1936	9,575.09
1937	9,575.09

Total

\$23,139.80

Forgiven interest

80,022.20

103,162.00

Adjusted basis, January 1, 1938

\$136,215.33

Market value of building (August 1, 1935) as found by Tax Court

\$141,000.00

Less: Depreciation allowable to Jan. 1, 1938

23,139.80

Adjusted basis, Jan. 1, 1938, computed on market value

\$117,860.20

Base for depreciation (larger amount)

\$136,215.33

Remaining life from Jan. 1, 1938 - 22.742 years.

Depreciation allowable

\$ 6,031.68

Depreciation previously allowed

5,300.00

Additional deduction

\$ 731.68

The amount of forgiven interest is computed as follows:

\$277,000.00 at 6 1/2% for period from 3-25-31 to 9-5-35

\$ 80,022.20

Schedule 12

Computation of Tax

Excess-Profits Tax

Net income, Schedule 10	\$ 9,448.24
Less: 10% of \$100,000.00, declared value of capital stock for year ended June 30, 1938	10,000.00
Balance subject to excess-profits tax	None
Excess-profits tax liability	None
Excess-profits tax assessed	None
Deficiency	None

168 Income Tax Computation

Net income, Schedule 10	\$ 9,448.24
Less: Excess-profits tax	None
Balance subject to income tax	\$ 9,448.24
Tax on \$5,000.00 at 12½%	\$ 625.00
Tax on \$4,448.24 at 14%	622.75
Total income tax	\$ 1,247.75
Income tax assessed:	
Original, account #420125	363.01
Deficiency in income tax	\$ 884.74

169 THE TAX COURT OF THE UNITED STATES.
 • • (Caption—106868) • •

Entered
 Jan. 9,
 1943.

DECISION.

Respondent having on January 4, 1943, filed a recomputation of tax for entry of decision as in accordance with the Findings of Fact and Opinion promulgated December 4, 1942, and petitioner having agreed thereto, now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the period August 1, to December 31, 1935,

in the amount of \$599.47; that there is no deficiency in excess-profits tax for the period August 1, to December 31, 1935; that there are deficiencies in income tax for the years 1936, 1937, and 1938 in the respective amounts of \$237.10, \$282.50, and \$884.74, and that there is no deficiency in excess-profits tax for the year 1938.

(Seal)

(S) Clarence V. Oppen,
Judge.

Entered Jan. 9, 1943.

Filed
Mar. 26,
1943.

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THE TAX COURT OF THE UNITED STATES.

(Caption—106868)

PETITION FOR REVIEW AND STATEMENT OF
POINTS.

(Filed Mar. 26, 1943.)

Now comes Claridge Apartments Company, a corporation, by Walter Hamilton, its attorney, and petitions the United States Circuit Court of Appeals for the Seventh Circuit for a review of the decision of the Tax Court of the United States rendered and entered January 9, 1943 in cause numbered 106868 on the docket of said Tax Court of the United States, wherein it was petitioner and the Commissioner of Internal Revenue was respondent and in support of its petition respectfully shows this Honorable Court as follows:

Venue.

The Petitioner is and was a corporation organized under the laws of the State of Illinois with its principal office at Chicago, Illinois in the judicial circuit of this Honorable Court. The income tax returns of the petitioner were filed for each of the taxable years, 1935, 1936, 1937 and 1938 in the office of the Collector of Internal Revenue for the Northern District of Illinois which office is, and was at the time said returns were filed located at Chicago and within said judicial circuit.

171 The respondent is the duly appointed, qualified, and acting commissioner of internal revenue of the

United States, holding office by virtue of the laws of the United States.

Prior Proceedings.

The Commissioner determined the deficiencies in income tax for said taxable years as follows:

	Income Tax	Excess Profits Tax
--	------------	--------------------

1935	\$844.39	\$57.05
1936	702.92	
1937	752.76	
1938	985.67	10.80

and thereafter petitioner filed its appeal from notice of deficiency with the Tax Court of the United States. The hearing of said appeal by the Tax Court of the United States was held February 25th and 26th, 1942. On December 4, 1942, the Tax Court of the United States promulgated its findings of fact and opinion in said appeal and on January 9, 1943, the Tax Court of the United States entered its final order of redetermination on said appeal, wherein and whereby the said Tax Court of the United States ordered and decided that there were deficiencies and penalties for the taxable years as follows:

	Income Tax
1935	\$599.47
1936	237.10
1937	282.50
1938	884.74

Total \$2003.81

Thereafter on January 19, 1943, your petitioner paid said taxes and interest so found and received receipt from Collector of Internal Revenue at Chicago, Illinois, in words and figures the following, to-wit:

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Petition for Review by Petitioner.

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Receipt for Payment of Taxes.

Form 1 (Revised May 1940)
 Treasury Department
 Internal Revenue Service

Income Tax
 (Class of Tax)

(Description of collection:
 tax, penalty, interest, or

offer in compromise, etc.)

Collector's Office First, District of Illinois
 at Chicago Date

(Name and Address of Taxpayer)

Claridge Apartments Co.,

9 D B T A

(Stamped)

Rec'd Return & Remittance

Jan. 19, 1943

Collector of Internal Rev.,

1st Dist., Ill.

Amount \$2619.30

Received Payment

ch

Collector of Internal Revenue

U. S. Government Printing Office

Said tax was so paid to stop the running of interest and to avoid filing appeal bond and with the understanding the amount paid would be returned to petitioner in case such findings and decision of the Tax Court of the United States is reversed.

Nature of the Controversy.

The question presented by the record and this petition for review is whether on August 1, 1935, when your petitioner received title to the premises in question in this case, by reason of reorganization of Claridge Building Corporation, an Illinois corporation, under Section 77B of the Federal Bankruptcy Act, it received it with the cost of the building to the Claridge Building Corporation as the basis of figuring depreciation for income tax purposes, as a tax free reorganization under Section 112 of the 1934 Internal Revenue Act of the United States or whether the market value of said building on that 1935 date should be taken as a basis of depreciation for income tax purposes of petitioner for said years on the ground it was not a tax free reorganization.

The Tax Court of the United States found that petitioner was entitled to take the cost of the said building to Claridge Building Corporation as a basis of depreciation for the years 1935, 1936, and 1937, but erroneously without any evidence to support its finding found that \$385,326.37 should be taken as the cost of such building in 1924 instead of \$424,609.19, which respondent had accepted without question for thirteen years and which was the cost of such building according to the only evidence on the subject which is documentary and unimpeached. The Tax Court of the United States also found the cost of the building as adjusted on August 1, 1935 was \$239,377.33, whereas there was no evidence to support such finding and without dispute in the issues the cost on that date should be \$246,082.66 if the erroneous basis of the said court is taken.

Also the Tax Court considered the effect of Section 270 of the Chandler Act of the United States on the reorganization as of May 14, 1935, whereas the effect of this Act was not put at issue by any pleadings in the case, and especially did the Tax Court of the United States find that the unpaid interest on \$277,000 of first mortgage indebtedness of Claridge Building Corporation prior to and at the date of the reorganization amounting to \$80,022.20 was used as an income tax benefit of Claridge Building Corporation and should be deducted from cost of the building as adjusted under Section 270 of the Chandler Act when ascertaining the depreciation in the return of petitioner for 1938, when that issue was not raised by the pleadings or evidence in the Tax Court of United States and there was no evidence whatever that such interest was so used as a tax benefit and all the evidence is to the contrary.

The tax court found that certain sums were deducted in the Income Tax Return for 1936 as decorating and 174 repairs and the same sums were deducted in the return of 1937. We contend there is no evidence to support this finding.

Statement of Points.

The Petitioner says that in the record and proceedings before the Tax Court of the United States, and in the decision and final order of redetermination rendered and entered by said Tax Court of the United States in said cause, manifest errors occurred and intervened to the prejudice of the petitioner, as follows:

1. The Tax Court of the United States erred in not holding and deciding that \$424,609.19 instead of \$385,326.37 was the cost of the apartment building at 4501 Malden St., Chicago, Illinois in 1924.

2. The Tax Court of the United States, erred in holding and deciding that \$239,377.33 was the adjusted cost of said building on August 1, 1935 instead of holding and deciding that \$246,082.66 was the adjusted cost of said building on said date on the basis of depreciation allowed for 13 years and not objected to or at issue in this case, if \$385,326.37 is taken as the cost of such building in 1924 instead of its real cost of \$424,609.19, but if the real cost is taken, \$285,355.48 is the correct figure.

3. The Tax Court of the United States erred in holding and deciding that \$80,022.20 delinquent interest was used as a tax benefit by Claridge Building Corporation when there was absolutely no evidence to this effect and all the evidence was the other way.

4. The Tax Court of the United States erred in making a finding and decision in regard to delinquent interest of Claridge Building Corporation, on its bond issue, being used or not used as a tax benefit by Claridge Building Corporation when no issue in regard thereto was made by the pleadings or evidence in this case.

175 5. The Tax Court of the United States was without jurisdiction to decide the issue mentioned in Point No. 4 hereof.

6. There is no evidence in the record to sustain the finding of the Tax Court of the United States that amounts deducted for decorating and repairs in the income tax returns of petitioner for 1936 were again deducted by it in income tax returns of 1937.

6. The finding of the Tax Court of the United States of the fair market value of the building on premises known as 4501 Malden St., Chicago, Illinois on Aug 1.

1935 was \$141,000 and not \$256,238.64 is unwarranted in the evidence.

7. The decisions of the Tax Court of the United States is contrary to and unsupported by the facts and evidence.

8. The Tax Court of the United States erred in not finding as a fact that the cost of the building at 4501 Malden St., Chicago, Illinois in 1924 at the time it was built was \$424,609.19.

9. The Tax Court of the United States erred in failing to find that the cost of such building as adjusted on August 1, 1935 was \$246,082.66 dollars, if \$385,326.37 be taken as its original cost, and that if the real cost is taken the remaining cost to be recovered on August 1, 1935 was \$285,355.48.

10. The Tax Court of the United States erred in not finding that the cost of the said building should not be sealed down by any deferred interest of the 1st mortgage bonds of Claridge Building Corporation.

11. The Tax Court of the United States erred as a matter of law in not holding and deciding there is no deficiency in the income and excess profits taxes of petitioner for any of the years 1935, 1936, 1937, and 1938.

Wherefore Petitioner Asks that the decision and order of the Tax Court of the United States in said case be reversed by the United States Circuit Court of Appeals for the Seventh Circuit and that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the clerk of said court for filing; that the appeal be without bond, the said tax having been paid under protest, and that appropriate action be taken to the end that the errors complained of may be reversed and corrected by said Court.

Claridge Apartments Company,

Walter Hamilton,

By Walter Hamilton,

Secretary.

Notice of Filing Petition.

State of Illinois }
 County of Cook } ss:

Walter Hamilton, being first duly sworn on oath, deposes and says that he is secretary of petitioner in the above petition, that he subscribed the same and that he knows the contents thereof and that the same are true in substance and in fact.

Walter Hamilton.

Subscribed and sworn to before me this 22 day of March, A. D. 1943.

Arthur Chittick,
Notary Public.

(Seal)

Walter Hamilton,
Attorney for Petitioner,
 29 S. La Salle St., Chicago.
 Tel: Franklin 4849.

The Attorney for Respondent is
 J. P. Wenchel,
 c/o Bureau of Internal Revenue
 Washington, D. C.

Filed
 Mar. 27,
 1943.

177 IS THE UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

Claridge Apartments Company, an
 Illinois Corporation,

Petitioner on Review.

vs.

Commissioner of Internal Revenue,

Respondent on Review.

B. T. A. Docket
 No. 106868.

NOTICE OF FILING PETITION FOR REVIEW AND
 STATEMENT OF POINTS.

(Filed Mar. 27, 1943.)

To: J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

You are hereby notified that Claridge Apartments Co., an Illinois Corp., did on the 26th day of March, 1943.

Petition for Review by Respondent.

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file with the Clerk of the Tax Court of The United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the Court heretofore rendered in the above entitled case. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated this 26th day of March, 1943.

B. D. Gamble,

B. D. Gamble,

Clerk, The Tax Court of The United States.

Service of copy of Petition for Review and Statement of Points acknowledged this Mar. 26, 1943.

(Signed) J. P. Wenchel

J. P. Wenchel,

Chief Counsel, Bureau of Internal Revenue,

Attorney for Respondent.

178 IN THE UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

Guy T. Helvering, Commissioner
of Internal Revenue,

Petitioner on Review,

vs.

Claridge Apartments Company,

Respondent on Review.

B. T. A. Docket

No: 106868.

PETITION FOR REVIEW.

(Filed Mar. 30, 1943.)

Guy T. Helvering, Commissioner of Internal Revenue, holding office by virtue of the laws of the United States, hereby petitions the United States Circuit Court of Appeals for the Seventh Circuit to review the decision entered by the Tax Court of the United States on January 9, 1943, ordering and deciding that there is a deficiency in income tax for the period August 1 to December 31, 1935, in the amount of \$599.47; that there is no deficiency in excess profits tax for the period August 1, to December 31, 1935; that there are deficiencies in income tax for the years 1936, 1937 and 1938 in the respective amounts of

Filed
Mar. 30,
1943.

\$237.10, \$282.50 and \$884.74, and that there is no deficiency in excess-profits tax for the year 1938. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

Claridge Apartments Company, a corporation organized under the laws of the State of Illinois, the respondent on review, filed its income and excess-profits tax returns (Form 1120) for the calendar years 1935, 1936, 1937 and 1938, with the Collector of Internal Revenue for the 179 First Illinois District, Chicago, Illinois, whose office is within the jurisdiction of the United States Circuit Court of Appeals for the Seventh Circuit.

(Sgd.) Samuel O. Clark, Jr.,

Assistant Attorney General

(Signed) J. P. Wenchel,

J. P. Wenchel,

Chief Counsel,

Bureau of Internal Revenue,

Counsel for Petitioner on Review.

Filed
Mar. 30,
1943

180 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

(Caption—106868)

STATEMENT OF POINTS.

(Filed Mar. 30, 1943.)

Now comes Guy T. Helvering, Commissioner of Internal Revenue, the petitioner on review herein, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and hereby asserts the following errors on which he intends to rely in this review:

The Tax Court erred:

1. In holding and deciding that the exchange of old bonds for new stock having a fair market value considerably less than the principal amount of such bonds, did not constitute a cancellation of indebtedness to the extent of such difference, under Section 270 of the Bankruptcy Act, as amended, by the Chandler Act, approved June 22, 1938, effective September 22, 1938 (Public No. 696, 75th Congress), 52 Stat. 840.

2. In holding and deciding that Section 270 of the Bankruptcy Act, as amended, is inapplicable to the de-

termination of basis for depreciation deductions for the calendar years 1935, 1936 and 1937.

3. In failing to uphold the retroactive application of Section 270 of the Bankruptcy Act, as amended, to the calendar years 1935, 1936 and 1937, as required by Articles 113(b)-2 of Regulations 86, 94, 101 and 103, as 181 amended by T. D. 4871, C. B. 1938-2, p. 130 and T. D. 5003, C. B. 1940-2, p. 107.

4. In entering its decision wherein it ordered and decided that there are deficiencies in income tax for the calendar years 1935, 1936 and 1937 in the respective amounts of \$599.47, \$237.10 and \$282.50.

5. In that its decision is not supported by the evidence.

6. In that its decision is contrary to law and regulations.

(Signed) J. P. Wenchel.

RLW

J. P. Wenchel.

Chief Counsel.

Bureau of Internal Revenue.

Counsel for Petitioner on Review.

182 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

(Caption—106868)

Filed
Mar. 30,
1943.

NOTICE OF FILING PETITION FOR REVIEW.

(Filed Mar. 30, 1943, Apr. 3, 1943.)

To: Walter Hamilton, Esquire,
29 South La Salle Street,
Chicago, Illinois.

You are hereby notified that the Commissioner of Internal Revenue did, on the 30th day of March, 1943, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review and a copy of the statement of points as filed are hereto attached and served upon you.

Dated this 30th day of March, 1943.

B. D. Gamble,

Clerk, U. S. Board of Tax Appeals.

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Notice of Filing Petition:

Service of the above and foregoing notice, together with copies of the petition for review and statement of points, is hereby acknowledged this 1st day of April, 1943.

(S.) Walter Hamilton,
Attorney for Respondent on Review.

Filed
Apr. 10,
1943.

185 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

(Caption—106868)

NOTICE OF FILING PETITION FOR REVIEW.

(Filed April 10, 1943.)

To: Claridge Apartments Company,
29 South La Salle Street,
Chicago, Illinois.

You are hereby notified that the Commissioner of Internal Revenue did, on the 30th day of March, 1943, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review and a copy of the statement of points as filed are hereto attached and served upon you.

Dated this 30th day of March, 1943.

(Signed) J. P. Wenchel.

RLW

J. P. Wenchel,
*Chief Counsel, Bureau of Internal
Revenue, Counsel for Petitioner
on Review.*

Personal service of the foregoing notice, together with copies of the petition for review and statement of points mentioned therein, is hereby acknowledged this 1st day of April, 1943.

Claridge Apartments Company,
By Walter Hamilton,
Secretary and Registered Agent.

JWS:rrz 3 29-43.

184 UNITED STATES CIRCUIT COURT OF APPEALS

Filed
Apr. 1,
1943.

For the Seventh Circuit.

April 1, 1943

Before

Hon. William M. Sparks, Circuit Judge.

Hon.

Hon.

• • (Caption) • •

(Filed April 3, 1943.)

On motion of counsel for petitioner, it is ordered that Petitioner's Exhibit 2 and Petitioner's Exhibit 11 shall not be printed, but shall be considered a part of the record in this cause, and that said exhibits be held by the Clerk of the Tax Court of the United States until ten days before this cause is argued in this Court.

It is further ordered that the Clerk of this Court transmit to the Clerk of the Tax Court of the United States a certified copy of this order.

185 UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten page contains a true copy of order entered this day in

Cause No. Tax Court No. 106868

Claridge Apartments Company,

Petitioner,

vs.

Commissioner of Internal Revenue,

Respondent,

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of

Appeals for the Seventh Circuit, at the City of Chicago,
this first day of April, A. D. 1943.

(S) Kenneth J. Carrick,
(Seal). *Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.*

Filed
Apr. 12,
1943.

186 IN THE UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

Claridge Apartments Company,
Petitioner on Review.

vs.

Guy T. Helvering, Commissioner
of Internal Revenue,
Respondent on Review.

Guy T. Helvering, Commissioner
of Internal Revenue,
Petitioner on Review.

vs.

Claridge Apartments Company,
Respondent on Review.

B. T. A. Docket
No. 106868.

ORDER.

(Filed April 12, 1943.)

Upon consideration of the joint motion filed herein by counsel for the parties in the above-captioned causes, It Is Ordered:

That the above captioned causes be and they are hereby consolidated for briefing, hearing, argument, and decision upon a single consolidated transcript of record, consisting of such portions of the record made before The Tax Court of the United States as the parties herein may indicate by their joint designation of contents of record, omitting any repetition of documents.

It Is Further Ordered that the Clerk of this Court transmit to the Clerk of The Tax Court of the United States a certified copy of this order to be by him incorporated in

Joint Designation of Record.

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the record on review as certified and transmitted by him to this Court.

(s) William M. Sparks,
Judge, U. S. Circuit Court of Appeals.

Dated:
April 9, 1943
Clerk

187 UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing Typewritten page contains a true copy of order entered April 9, 1943, in

(Caption—106868)

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this tenth day of April, A. D. 1943.

(Seal) (S) Kenneth J. Carrick,
Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

188 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

(Caption—106868)

Filed
Apr. 10,
1943.

JOINT DESIGNATION OF CONTENTS OF RECORD
ON REVIEW.

(Filed April 10, 1943.)

To the Clerk of The Tax Court of the United States:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit copies duly certified as correct of the following documents and records in the above-entitled cause

Joint Designation of Record.

in connection with the petition for review heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceeding before the United States Board of Tax Appeals (now The Tax Court of the United States).

2. Pleadings before the Tax Court:

(a) Petition including annexed copy of deficiency letter (Exhibit A).

(b) Answer.

189 3. Findings of fact, opinion and decision.

4. Respondent's computation for entry of decision.

5. Statement of evidence with petitioner's exhibits 3 to 10, inclusive, and 12, and respondent's exhibits A to I, inclusive.

6. Petition for review filed by the taxpayer, together with proof of service of notice of filing and of service of a copy of petition for review.

7. Petition for review filed by the Commissioner, together with proof of service of notice of filing and of service of a copy of petition for review.

8. Statement of Points to be relied upon by taxpayer.

9. Statement of Points to be relied upon by Commissioner.

10. Order of Court granting permission to transmit to the Clerk of the Court petitioner's exhibits 2 and 11 in physical form.

11. Order of Court consolidating the above-captioned causes for briefing, hearing, argument, and decision.

12. This joint designation of contents of record on review.

(S) Walter Hamilton.

Walter Hamilton.

29 South La Salle Street.

Chicago, Illinois.

Counsel for taxpayer.

(Signed) J. P. Wenchel.

RLW

J. P. Wenchel.

Chief Counsel, Bureau of Internal Revenue, Counsel for Commissioner.

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THE TAX COURT OF THE UNITED STATES.
• • (Caption—106868) • •

CERTIFICATE.

I, B. D. Gamble, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 191, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 22d day of April, 1943.

(Seal)

B. D. Gamble,
*Clerk, The Tax Court of the
United States.*

UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of the printed record, printed under my supervision and filed on the fourth day of August, 1943, in:

Claridge Apartments Company, an
Illinois Corporation,
Petitioner,

8296

vs.

Commissioner of Internal Revenue,
Respondent.

Petition for Review of Decision of the Tax Court of the United States.

Commissioner of Internal Revenue,
Petitioner,

8297

vs.

Claridge Apartments Company, an
Illinois Corporation,
Respondent.

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 3rd day of February, A. D. 1944.

Kenneth J. Carrick,

Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.

(Seal)

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, held in the City of Chicago, and begun on the sixth day of October, in the year of our Lord one thousand nine hundred and forty-two, and of our Independence, the one hundred and sixty-seventh.

Claridge Apartments Company, an
Illinois Corporation,
Petitioner,

8296

vs.

Commissioner of Internal Revenue,
Respondent.

Petition for Review of
Decision of the Tax Court
of the United States.

Commissioner of Internal Revenue,
Petitioner,

8297

vs.

Claridge Apartments Company, an
Illinois Corporation,
Respondent.

And afterwards, to-wit: On the first day of December, 1943, there was filed in the office of the Clerk of this Court, the Opinion of the Court, which said Opinion is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS
For the Seventh Circuit.

Nos. 8296-8297.

October Term and Session, 1943.

CLARIDGE APARTMENTS COMPANY,
an Illinois Corporation,

Petitioner.

No. 8296

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

COMMISSIONER OF INTERNAL
REVENUE,

Petitioner.

No. 8297

vs.

CLARIDGE APARTMENTS COMPANY,
an Illinois Corporation,

Respondent.

Petitions for Review of De-
cision of the Tax Court
of the United States.

December 1, 1943.

Before EVANS and MINTON, *Circuit Judges*, and LINDLEY,
District Judge.

EVANS, *Circuit Judge*. This is a Federal income tax case wherein the chief issue arises out of the disputed basis for the depreciation of a large apartment building, acquired by taxpayer in 1935 in a Sec. 77B bankruptcy reorganization proceeding. Corollary issues are:

(1) The applicability of Sec. 270 of the Chandler amendment to the Bankruptcy Act, providing for a decrease of the predecessor's depreciation basis proportionate to a cancellation or reduction of indebtedness through a 77B reorganization. In other words, and to be more specific, taxpayer challenges the soundness of the Commissioner's

holding that an exchange of stock for bonds constitutes a "cancellation or reduction" of the debt within Section 270.

(2) The possible retroactive effect of Sec. 270 to prior tax years in which years the tax has already been paid.

(3) The decrease of the depreciation base by the amount of interest liability allegedly forgiven in the reorganization.

(4) The propriety of the Tax Court's exclusion, from the base, of a substantial sum claimed to have been paid as commission to the entrepreneur of the property.

(5) The refusal of the Tax Court to permit deduction of certain expenses of upkeep of the property.

(6) A separate and distinct issue, arising out of taxpayer's challenge of evidentiary support of the Tax Court's finding as to the value of the property in 1924, is also conditionally present.

The aforesaid legal questions arise out of a rather simple fact statement, with factual *dispute* well nigh nil.

The property involved is a 106 apartment building in Chicago, which was erected upon a vacant lot owned by Charles F. Henry, a contractor and builder. In 1924, Henry erected this building at an alleged cost of \$385,326.37. He conveyed the land to taxpayer's predecessor, taking in payment therefor, all of its \$100,000 of par value stock. He asserted that he earned and took a commission of ten per cent of the building cost, i. e., \$38,532.64, for services in supervising the construction of the building. This item was excluded by the United States Tax Court in its determination of the cost of the building.

The taxpayer's predecessor fixed its basis for depreciation by adding three items: first, the \$385,326.37 cost of the building; second, \$38,532.64, for contractor's services in supervising construction; and third, a miscellaneous item of \$750.18. On this basis, taxpayer's predecessor each year, in its income tax return, made its depreciation deduction. Up to August 1, 1935, when the taxpayer acquired the property upon the completion of the reorganization proceedings, a total depreciation of \$139,253.71 had been charged. This left (with minor other adjustments not here important) an adjusted depreciation basis of \$239,377.33. Taxpayer asserts this should be accepted as the depreciation basis for the years in dispute (1935-1938).

The Commissioner makes different computations and reaches a different conclusion. Factually, he challenged only the \$38,532.64 item in the taxpayer's base, which item the U. S. Tax Court disallowed.*

Commissioner's position is more nearly one of confession and avoidance. He asserts that the proper basis for depreciation was not \$239,371.33, but rather a sum which was also the market value of the building on August 1, 1935, when the taxpayer acquired the property. The fair value was \$164,450.

Commissioner reached his conclusion in this way: In March, 1924, taxpayer's predecessor floated a \$340,000 6 1/2% bond issue which was defaulted in October, 1931, at which time \$277,000 of bonds were still outstanding. In February, 1932, there was a foreclosure decree, and in June, 1934, bankruptcy proceedings were instituted under Sec. 77B. A plan of reorganization was approved in May, 1935, and the final decree entered, March 1, 1937. The execution of that plan necessitated the exchange of ninety per cent of taxpayer's no par stock for the \$277,000 of bonds,—one share for each one hundred dollars face value of bonds—and the remaining ten per cent of stock going to predecessor's stockholders. The Court found the fair market value of this stock never exceeded \$45 per share.

The Tax Court found that the fair market value of the building at the time of the confirmation of the plan was not in excess of \$141,000 and the fair market value of the land was \$16,000.**

Whether we should accept taxpayer's base of \$239,371.33 or the Commissioner's here-asserted base of \$141,000 turns not so much upon the ascertainment of the facts (concerning which there is dispute as to one item only) as it does on the Commissioner's legal contention that in determining the basis of depreciation he was required to reduce the original basis by the amount of indebtedness of the predecessor which was cancelled or reduced in said bankruptcy proceeding, not however below the fair market value of the property.

* This disallowance was wrongful, so taxpayer here contends, and he asks this court to correct it.

** Although especially irrelevant to the issue, it appears that in July 1940, after the completion of the Sec. 77B reorganization the building and lot were sold for the sum of \$126,000 and the assumption of \$20,000 liabilities.

In other words, we are confronted preliminarily by two questions.

First, by accepting stock in taxpayer company and surrendering the bonds of taxpayer's predecessor, was there a "cancellation or reduction" of the amount of the original indebtedness of taxpayer's predecessor? If this question be answered in the affirmative, then certain other issues become unimportant because of the United States Tax Court's finding that the value of the building in 1935 was \$141,000.

The second question is the applicability of Sec. 270 to the determination of a depreciation base made prior to its enactment. In other words, is Sec. 270 retroactive so as to affect the tax base for depreciation for tax years prior to its enactment.

The decision of the Tax Court satisfied neither party. Both sides appealed (and one brief *amicus curiae* had been filed). Their appeals have been consolidated in this court.

The Tax Court held: (1) Section 270 was applicable to the tax year 1938. (2) Section 270 was not applicable to the prior tax years. (3) There was no "cancellation or reduction" of the indebtedness within the meaning of this statute when the bonds were exchanged for stock of equal book value, so as to require diminution of the depreciation base. (4) The interest item which was wiped out in the reorganization was deductible, under Sec. 270, from the 1938 depreciation base. (5) The 10% commission was improperly included in the original cost, and therefore in the depreciation base. (6) Certain items of taxpayer's alleged expense were, by it, improperly deducted.

The Commissioner appeals from rulings (2) and (3). The taxpayer appeals from the holding of the court in (1), (4), (5), and (6).

Several of the above-stated issues will become moot if the Government's first contention, namely, that Sec. 270 controls, is upheld. We therefore turn first to a consideration of this section, which is quoted below.* Also quoted is Sec. 268.

* Sec. 270 [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 769]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including ac-

Rejecting the Government's urge that this section applied, the Tax Court said:

"The substitution of common stock for bonds is not a cancellation or reduction of the liability represented by the bonds, no matter how much less the stock may be worth, since the assets are not thereby freed from obligation." While the bond loan has been terminated, the amount borrowed is now committed to capital stock liability instead of to the liability of a fixed indebtedness."

We are unable to accept this view of the statute. The acceptance of the stock for the bonds wiped out a direct debt liability, enforceable by legal action. The debt carried an interest obligation and priority of rights. The stock carried no right to interest and not even to dividends, unless surplus existed; and a declaration of distribution had been made. It carried no right to collect the sum represented by the investment therein. At best it is a right only to a proportionate distribution of the assets over and above all debts of the corporation, in case of liquidation.

As the Court said in *Eyster v. Centennial Board of Finance*, 94 U. S. 500, 502:

"The liability of a corporation to its stockholders on account of their stock is not a debt. The shares of a stockholder represent his proportion of the property of a corporation; and, upon the winding up of its affairs, the assets remaining after all liabilities are discharged are for division among the stockholders, according to their respec-

earned interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary, in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section." (Italics ours.)

"Sec. 268. Except as provided in section 270 of this Act, no income or profit taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancellation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter."

tive interest. The payment to stockholders upon such a division is for a dividend of the property divided, not for a debt owing by the corporation."

The words "cancelled or reduced," as used in this statute, are comprehensive. Given their ordinary or literal meaning, they cover a case such as is here presented. Here there was an elimination of the bonded indebtedness. Assume that the former bondholders, in accepting the stock in the new company, received all of the assets of the old company (they received only 90%) and the new company had the same assets as the old company, they still gave up their status as creditors with the correlative right to interest, to sue to collect a debt if default occurred, to priority against lesser and subsequent creditors. They also gave up the interest which they forgave.

If we search for the intent of Congress as affecting the construction of these words, the taxpayer is in no better position.

The financial crash of '29 caused values of real estate and buildings thereon to tumble. The Chandler Act dealt with the reorganization of companies which held such properties. It dealt with debtors that had outstanding mortgages and other indebtednesses in excess of the value of their real properties. When the reorganization of these debtors was completed, in many instances the indebtednesses were greatly reduced or cancelled. In the instant case the debt was entirely eliminated. In place thereof, stock of much less market value than the face value of the debt, was issued.

It would be both illogical and unfair to retain a fictitious depreciation basis for tax purposes when the actual valuation in the reorganization of the debtor was much less. Congress was dealing with realities. It sought not only to avoid injustice to the Government, but also prevented injustice being done to the taxpayer. It should be noted that Section 270 contained a provision which prevented the depreciation basis going below the fair value of the building.

If taxpayer's construction of this section be adopted, then a reorganized debtor could claim a depreciation based upon a value twice or three times as much as the real value of the building.

Our conclusion is that Sec. 270 applies to a case where there has been a reorganization and the existing debt either

cancelled or diminished and also to cases where stock in the new debtor is issued in place of such indebtedness. And this is so even though the par value (not the market value) of the stock was the same as the face value of the mortgage indebtedness.

This brings us to the consideration of the date of the application of Section 270 of the Bankruptcy Act, as amended by the Chandler Amendment. In other words, we meet directly, the query, Did Section 270 apply to years prior to the date of its enactment, that is, prior to the tax year of 1938?

It must readily be conceded that retroactive effect to legislation will never be given unless such purpose is expressly stated, or is to be inferred by clear intent, or by the necessary and unavoidable implications of the legislation. *Hassett v. Welch*, 303 U. S. 303; *U. S. v. Dakota Co.*, 288 U. S. 459; Mertens, Law of Fed. Income Taxation, Sec. 3.33; *Brewster v. Gage*, 280 U. S. 237.

On this theory, the Board of Tax Appeals held in *Commissioner v. Commodore*, 46 B. T. A. 718, that Sec. 270 did not apply to years prior to 1938. Its decision was affirmed by the Circuit Court of Appeals of the Sixth Circuit in 135 F. 2d. 89.

We think the legislative intent here is not left in doubt, for Congress in Sec. 276 (c) (3) expressly provided:

"Sections 268 and 270 of this Act shall apply to any plan confirmed under section 77 B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date . . ."

In the face of this express statute, judicial search for Congressional intent becomes a somewhat idle, or futile task. Our inquiry, if limited at all, is restricted to the meaning of the words which Congress used, when in Sec. 276 (c) (3) it made specific provision for the effective date of the application of said Section 270, that is when it expressly provided that Sec. 270 was retroactive in its application.

Assuming doubt and uncertainty in the words of said Section 276 (c) (3) for the moment, it is interesting to note that Congress here dealt with both Section 270 and Section 268. The three sections, 268, 270, and 276, therefore,

should be read together. Sections 268 and 270 are complementary. Section 268 relieves the debtor corporation of a tax on any of its income represented by the cancellation of an indebtedness in a reorganization proceeding under Chap. X. We must read Section 270 in the light of this Sec. 268 tax exemption.

Debtor reorganization under the Bankruptcy Laws nearly always results in a reduction of the outstanding indebtedness. In fact, reorganizations are for the avowed purpose of avoiding the evil effects of over-indebtedness. This is accomplished, when the reorganizations are in good faith, by reduction or the elimination of all or a part of the debt burden.

Such a reduction of the debt of the reorganized debtor, however, might result in a so-called profit to the corporation. This occurs by reason of the lessening, or extinction, of its debt. By Section 268, Congress provided for this contingency and relieved the debtor from an income tax on such a possible charge of profit. On the other hand, were it not for Section 270, the debtor would profit unfairly. It would continue a depreciation base for tax purposes that is out of line with its actual value. It would be getting a benefit, which it should receive, under Section 268, but at the same time it would evade its taxes in so far as they reflected a false and exaggerated depreciation base.

Notwithstanding the logic which inheres in the relation of Sec. 268 and Sec. 270, and the reference to both of them in Sec. 276 (c) (3), we would not be inclined to go behind the date of the passage of the Act, unless the language of said Sec. 276 leads clearly and irresistibly to such a construction.

And so we come to the words of the statute, to-wit:

"Sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B *before the effective date of this amendatory Act* and to any plan which may be confirmed under section 77B on and after such effective date

Given their ordinary meaning, the words "before the effective date of this amendatory Act" mean that it, the Act, applies to reorganizations which were confirmed before June 22, 1938, the date of the passage of Secs. 268, 270, and 276 (c) (3).

We are not, therefore, giving effect to any doubtful or veiled or unexpressed intention of Congress. We are giving effect to the words Congress used when it made Sections 268 and 270 retroactive in their application.

Should we limit the date in any manner? In the present case we are not required to go beyond bankruptcy reorganization tax cases which had not been closed and barred by the statute of limitations when the June, 1938 amendment became effective. The years to which the Commissioner attempted to apply Section 270 may well be called *open tax years*. As to such years both parties may obtain an adjustment. The taxpayer may get an adjustment under Sec. 268. The Commissioner may adjust the taxpayer's tax under Sec. 270. We hold that Sec. 276 (c) (3) makes Sec. 270 applicable to taxpayer's tax for all the years in controversy, 1935, 1936, 1937, and 1938.

Aside from the express language of the statute, it seems clear that the same application should be given to Sec. 270 as to Sec. 268.

Finally, if we give the same effective date of application to both Sections 268 and 270, we are dealing with realities, with facts as they are. We are relieving an involved debtor from an income tax on a profit which it did not make when its debts were reduced; and we are asking it to figure its depreciation on a basis which accords with the facts, not with figures that are fictional and have no connection with values of today. Why should we attribute to words of a statute a meaning which would continue the make-believe, water values that were wrung out of them in the reorganization proceedings.

That such a construction would violate no provision of our Constitution, we are satisfied. *Stockdale v. Ins. Cos.*, 87 U. S. 323; *Brushaber v. Union R. Co.*, 240 U. S. 1; *Cens. Utilities Co. v. Com.*, 84 F. 2d. 548; *Jackson v. Price*, 74 F. 2d. 707; *Wilgard Co. v. Com.*, 127 F. 2d. 514.

Taxpayer challenged the disallowance of two small items, to-wit, \$1291.44 and \$389.60, for decoration and repairs in the year 1937. The disallowances were made because the same sums for the same purposes had been claimed in taxpayer's 1936 tax return. The Tax Court held,

"Since we are satisfied from the evidence that petitioner is seeking for 1937 a deduction already taken and allowed for the prior year, respondent's disallowance is approved."

Our conclusion on this issue is that the evidence is conflicting, and we can not disturb a finding which has evidence to support it.

Our conclusion that Sec. 270 governs makes it unnecessary for us to consider the fact issue raised by the taxpayer for a charge made by the contractor, Henry, of ten per cent, or \$38,532.64, which he added to the building cost as a profit which he charged himself for erecting the building. The full reduction in the depreciation has not been made because Section 270 forbids the adjustment going lower than the fair market value. This being so, this item has no bearing in the outcome if said Section 270 applies.

In the appeal of the Commissioner, No. 8297, the order of the Tax Court is reversed with directions to enter an order in accord with the views here expressed. In the appeal of Claridge Apartments Company, No. 8296, those portions of the order from which this appeal is taken, are

AFFIRMED.

Endorsed: Filed December 1, 1943. Kenneth J. Carrick, Clerk.

And on the same day, to-wit: On the first day of December, 1943, the following further proceedings were had and entered of record, to-wit:

Wednesday, December 1, 1943.

Court met pursuant to adjournment.

Before:

Hon. Evan A. Evans, Circuit Judge.

Hon. Sherman Minton, Circuit Judge.

Hon. Walter C. Lindley, District Judge.

• • • (Caption—8296) • • •

This cause came on to be heard on the transcript of the record from the Tax Court of the United States and was argued by counsel:

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on January 9, 1943, be, and the same is hereby, affirmed as to the portions of said decision herein appealed from.

And on the same day, to-wit: On the first day of December, 1943, the following further proceedings were had and entered of record, to-wit:

Wednesday, December 1, 1943.

Court met pursuant to adjournment.

Before:

Hon. Evan A. Evans, Circuit Judge.
Hon. Sherman Minton, Circuit Judge.
Hon. Walter C. Lindley, District Judge.
* * * (Caption—8297) * *

This cause came on to be heard on the transcript of the record from the Tax Court of the United States and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on January 9, 1943, be, and the same is hereby reversed, and that this cause be, and the same is hereby, remanded to the said Tax Court of the United States with directions to enter an order in accord with the views expressed in the opinion of this Court.

And afterwards, to-wit: On the twenty-second day of December, 1943, the following further proceedings were had and entered of record, to-wit:

Saturday, December 22, 1943.

Court met pursuant to adjournment.

Before:

Hon. Evan A. Evans, Circuit Judge.
Hon. Sherman Minton, Circuit Judge.
Hon. Walter C. Lindley, District Judge.
* * * (Caption—8296 and 8297) * *

It is ordered by the Court that the petition for a rehearing of this cause be, and it is hereby, denied.

And afterwards, to-wit: On the twenty-fifth day of January, 1944, there was filed in the office of the Clerk of this Court, a Stipulation for Record, which said stipulation is in the words and figures following, to-wit:

(Caption—8296-8297) • •

STIPULATION.

It is stipulated that the supplemental record, for the purpose of filing petition for certiorari, shall include only the following:

1. The opinion of the Circuit Court of Appeals.
2. The judgment of the Circuit Court of Appeals.
3. The order denying the petition for rehearing and that all captions may be omitted.

Wm. E. Hughes,
Attorney for Claridge Apartments.
Charles Fahye,
Solicitor General,
Samuel S. Clark,
Assistant Attorney General,
Attorney for Commissioner of
Internal Revenue.

Endorsed: Filed January 25, 1944. Kenneth J. Carrick,
Clerk.

UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of the proceedings had and papers filed as called for by the designation for record on petition for writ of Certiorari, filed on the twenty-fourth day of January, in:

Claridge Apartments Company, an
Illinois Corporation,

Petitioner.

8296

vs.

Commissioner of Internal Revenue,

Respondent.

Petition for Review of Decision of the Tax Court of the United States.

Commissioner of Internal Revenue,

Petitioner.

8297

vs.

Claridge Apartments Company, an
Illinois Corporation,

Respondent.

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 3rd day of February, A. D. 1944.

(Seal)

Kenneth J. Carrick,
*Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.*

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1944

No. 28

ORDER ALLOWING CERTIORARI—Filed March 27, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1944

No. 29

ORDER ALLOWING CERTIORARI—Filed March 27, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(3268)

No. [REDACTED] 28

IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SEVENTH CIRCUIT AND BRIEF
IN SUPPORT THEREOF.**

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Claridge Apartment Company, an Illinois Corporation, by its attorneys, John E. Hughes, Walter Hamilton, Jesse Andrews and Cornelius E. Lombardi, prays that a Writ of Certiorari issue to review the decision of the United States Circuit Court of Appeals for the Seventh Circuit, entered December 1, 1943, in case No. 8297 below, reversing the judgment of the Tax Court of the United States in the above entitled case (No. 8297 below). (R. 238)

Opinions Below.

The opinion of the Tax Court of the United States is reported in 1 T. C. 163 and appears in this record at page 183. The opinion of the Circuit Court of Appeals is reported in 138 F. (2d) 963 and appears in this record at page 228.

Jurisdiction of the Court.

The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended (28 U. S. C. A. §347, (a)).

Questions Presented.

(1) Is indebtedness "canceled or reduced", within the meaning of the Chandler Act, when the creditors take over the debtor's property for such indebtedness? To put it another way—when a mortgagee forecloses and takes the mortgagor's home, does he thereby "cancel or reduce" the mortgagor's debt? If the Tax Court was right in its conclusion on this point and the court below wrong in reversing it, the other questions in this case are moot.

(2) Conceding that Section 270 of the Chandler Act, enacted September 22, 1938, applies to plans confirmed before its enactment, is it retroactive so as to apply to the computation of taxes for years prior to its enactment as the court below held, or does it only apply to such plans for purpose of tax computation starting with the year of its enactment, as the Tax Court held?

(3) If, as constructed by the Court below, it applies to impose additional 1935 tax, does it violate the due process clause of the Fifth Amendment?

(4) Conceding section 270 applies to plans confirmed before its enactment since, as here, nearly two years and sometimes more, often elapse between confirmation of a plan and final decree, does section 270 only apply where the proceeding was not pending when it was enacted?

(5) Was there a rational basis for the decision of the Tax Court, which the court below reversed?

Statutes Involved.

The statutes involved are set forth in the appendix hereof at pages 21 to 23.

Statement of Matter Involved.

This case involves income tax deficiencies for the calendar years 1935, 1936, 1937 and 1938 and excess profits tax deficiencies for 1935 and 1938.

Section 270 of the Chandler Act was enacted September 22, 1938. The Tax Court held that it applied to all plans before its enactment but it was not retroactive so as to govern computation of deficiencies for the years 1935, 1936 and 1937 but only applicable to the computation of the deficiency starting with 1938—the year of its enactment. The Circuit Court of Appeals for the Sixth Circuit in *Commissioner v. The Commodore, Inc.*, 135 F. (2d) 89, affirmed a decision of the Board of Tax Appeals so holding (46 B. T. A. 718). The court below announced its disagreement with this decision of the Sixth Circuit and reversed the Tax Court.

The second question is whether, conceding sections 270 and 268 apply to plans confirmed before their enactment, does the Statute (Appendix 22) limit their application to cases which were pending at the date of their enactment and cases arising in the future?

4

The third presented question here is whether (for 1938, to which the Tax Court held Section 270 applied) petitioner's indebtedness was "canceled or reduced" within the meaning of section 270. The Tax Court held it was not. The court below reversed the Tax Court and held it was. If the Tax Court was right on this point, it disposes of this case and under the other questions moot.

The salient facts on this point are as follows:

The Claridge Building Corporation owned an apartment building in Chicago. It had cost it \$424,609.19 to build. On June 16, 1934 it had outstanding \$277,000 six and one-half per cent first mortgage bonds on which principal and interest were in default. On that date it filed a voluntary petition in the United States District Court, under Section 77B of the National Bankruptcy Act.

A plan of reorganization was entered into and confirmed by the Court May 14, 1935 (final decree March 1, 1937) whereby petitioner corporation was formed with 3080 shares of no par value stock and the property of the debtor transferred to it. Its shares were issued on September 2, 1935, one for each \$100. face value bond, 2770 being issued to the bondholders, 308 shares to the debtor's stockholders, and 2 shares being unissued.

Respondent contended the debt of the old corporation was "canceled or reduced" by the difference between the fair market value of the stock issued to the bondholders and the face value of their bonds. (We submit, if any debt was canceled or reduced by this proceeding, it was all canceled.) The Tax Court reversed and held the debt was not thereby "canceled or reduced". The Court of Appeals reversed the Tax Court and held it was "canceled or re-

duced" by the difference between the \$277,000 face value of the bonds and the market value of the stock issued to the bondholders which market value was \$124,650. The fair market value of the building on May 14, 1935, was \$141,000.

Reasons for Granting the Writ.

First—The decision below in holding section 270 retroactively applicable to the computation of taxes for years before its enactment is in conceded and square conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Commissioner v. The Commodore, Inc.*, 135 F. (2d) 89.

Second—The question whether debt is canceled or reduced in circumstances such as this exists in hundreds of 77B reorganizations. In cases arising in other circuits The Tax Court will probably adhere to the view it expressed in this case. The government will appeal if it does. Taxpayers will appeal if it does not. Litigation and settlement of hundreds of cases will be prolonged unless the writ is granted and this question settled now. A question of great importance in tax law, which has not been but should be settled by this court, is involved.

In *Alcazar Hotel, Inc.*, 1 T. C. 873 (pending on appeal, C. C. A. 6th), the Tax Court said (p. 879):

"This contention, too, may be disposed of by reference to our decision in *Claridge Apartments Co., supra*. Following *Capitol Securities Co.*, 47 B. T. A. 694, we held the substitution of common stock for bonds did not effect a cancellation or reduction of indebtedness, but rather amounted to a continuation of the obligation in another form."

The Circuit Court of Appeals for the First Circuit has just affirmed the Board's decision in the *Capento Securities Co.* case. 1944 C. C. H. Tax Service, par. 9170.

Third—When the court below upset The Tax Court's decision it did not have the benefit of this court's decision in the *Dobson* case, holding a Tax Court decision resting upon a rational basis cannot be upset.

Fourth—The decision of the court below on questions (1) and (2) is patently wrong (see annexed brief) and that of The Tax Court is obviously right—a circumstance which will multiply and prolong litigation until the question is settled by this court.

Wherefore, it is respectfully submitted that this court should grant the writ of certiorari to review the decision of the Circuit Court of Appeals for the Seventh Circuit in case Number 8297 below.

JOHN E. HUGHES,

WALTER HAMILTON,

JESSE ANDREWS,

CORNELIUS E. LOMBARDI,

Counsel for Petitioner

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

In *Dobson v. Commissioner*, 320 U. S. _____, this court said:

"The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body" (citing many cases).

The Court of Appeals for the District of Columbia has just stated this is the only question before a court of appeals in ordinary appeals from the Tax Court. *Commissioner v. Celanese Corporation*, C. C. H. Tax Service, 1943, paragraph 9147.

Tested by this rule the court below had no right to reverse the decision of the Tax Court in the case at bar.

I.

The debt was not "canceled or reduced" within the meaning of Section 270.

The Tax Court properly so held and the court below improperly reversed. If the Tax Court was right the other questions in the foregoing petition are out of the case.

The Tax Court held the facts in the case at bar gave rise to a non taxable reorganization and respondent did not appeal this point to the court below.

In a reorganization the basis of the old corporation carries over to the new (*Palm Springs Holding Company v. Commissioner*, 315 U. S. 185) and, by the express provisions of section 113 (b)(3) of the Internal Revenue Code and pre-existing provisions of the revenue acts, bondholders and stockholders of the old corporation, who received stock in the new one, are denied any loss. Also section 112 (b) (4) prevented either corporation realizing any income. These provisions long antedated the Chandler Act.

If any debt was "canceled or reduced" in this case all of it was canceled or reduced, which reveals the absurdity of the construction of the court below because there would then be a zero basis to many corporations organized under 77B. The 1940 Amendment prevented the reduction going beyond the fair market value but the meaning of the 1938 Act was fixed at the date it became law and surely Congress could not have intended this in a bankruptcy act designed for the relief of debtors.

Meaning of the words "canceled or reduced."

A cancellation occurs when an indebtedness is not accorded recognition in a plan of reorganization and a reduction occurs only when the indebtedness is accorded recognition in a reduced amount. Where recognized to the extent of its full amount the debt has not been "reduced or canceled" regardless of the nature of the provisions with respect thereto.

In virtually every reorganization the value of the property is less than the face amount of debt yet the full amount of the senior debt is recognized by issue of stock and the junior debt canceled. The value of the property and the actual value of the senior debt are the same in cases where the debt accorded recognition takes the entire property. Also, in most large reorganizations secondary bond or note issues were canceled and not recognized.

In cases where the value of the property is not in excess of the first lien debt no provision for secondary debt is made and it is thereby canceled. If the value of the property exceeds the first lien debt, but doesn't equal the junior debt, the secondary debt is often recognized only in part.

If Congress had intended that debt fully recognized in a reorganization and exchanged for stock be considered "canceled or reduced" it could have precisely said so, leaving no room for doubt and uncertainty.

Section 268 arose from the suggestion of Mr. Banks, a member of the National Bankruptcy Committee and section 270 from the suggestion of Mr. Kent of the Treasury. See Judiciary Committee Hearings on Revision of the Bankruptcy Act, 75 Congress, 1st session, pages 266 to 268 and 352 to 354. Kent's example at page 353 supports the construction for which we contend. He said if a corporation bought property for \$1,000,000, later became financially involved and the seller reduced the price to \$750,000, and thereafter conditions improved and it sold the property for \$1,000,000, the \$250,000 profit would escape tax if a \$1,000,000 base was used. The committee report shows Congress intended to provide for cases such as that and not cases like this at bar.

The first rule of statutory construction is "unless Congress has definitely indicated its intention that the words should be considered otherwise, we must apply them according to their usual acceptation." *Arery v. Commissioner*, 292 U. S. 210, 214. As said in 53 Harvard Law Review at page 1009: "In popular parlance no one would ordinarily use the words 'canceled or reduced' in speaking, for example, of the conversion of debt into stock in a purely capital transaction." On the other hand, if we assume the meaning of the words is doubtful then the rule of statutory construction is "if doubt exists as to the construction of a taxing statute the doubt should be resolved in favor of the taxpayer." *Hassett v. Welch*, 303 U. S. 303, 314, and cases there cited.

It is submitted the words are not doubtful but, if they are doubtful, then resort should be had to the intention of Congress as disclosed in the report of the committee reporting the bill. This intention was to cover cases such as embraced in note 1 hereof and not cases like the one at bar.

The Senate Judiciary Committee report referred to "debt forgiveness" stating:

"This provision is intended to prevent a double deduction. Where debt forgiveness resulting from a debt readjustment is exempt from tax upon income or profit, the cost of the property dealt with by the settlement is to be decreased for future tax purposes, by an amount equal to the amount of the indebtedness canceled or reduced in the proceeding." (S. Rep. No. 1916: 75th Congress, 3rd Session, page 39.)

There was no "debt forgiveness" here. If the debt of the old company had been forgiven or canceled it could have continued in business free of debt. The creditors, instead of forgiving or canceling their debt, exacted their full pound of flesh and, in effect, foreclosed the mortgage.

There was no double deduction because there was no income for section 268 to exempt from tax.

Not only did the court below fail to perceive the effect of the reorganization provisions on the situation (page 17 hereof) but its opinion discloses a misconception of the base and reason for the depreciation allowance such as should lead this court to extend its decision in the *Dobson* case limiting the scope of review.

• The court below says:

"It would be both illogical and unfair to retain a fictitious depreciation basis for tax purposes when the actual valuation in the reorganization of the debtor was much less. Congress was dealing with realities. It sought not only to avoid injustice to the Government, but also prevented injustice being done to the taxpayer. It should be noted that Section 270 contained a provision which prevented the depreciation basis going below the fair value of the building.

"If taxpayer's construction of this section be adopted, then a reorganized debtor could claim a depreciation based upon a value twice or three times as much as the real value of the building."

What the Court overlooks here are two things:

1. That a depreciation basis represents the capital that a taxpayer is entitled to have returned to it free of tax. The Court seems to think that if in some way this basis has come to exceed the actual value of the property, it is "a fictitious depreciation basis" and the retention of it is "both illogical and unfair". This is not so. It matters not how much the depreciation basis exceeds the actual value of the property nor how much the property exceeds the depreciation base. It would be illogical, unfair and an unconstitutional capital levy to reduce it, until and unless the taxpayer has been given an equivalent in return for

such reduction. Sec. 270 can constitutionally apply in the cases in which it was intended to apply, because in those cases the taxpayers will have been accorded relief by Sec. 268 from tax liability resulting, pursuant to the *Kirby Lumber Company* case, from a modification or cancellation of their indebtedness. The depreciation base and base for computing profit on sale are the same—cost.

2. The second thing the Court overlooks is that it is entirely consistent with law and expressly provided for a reorganized debtor to be able to "claim a depreciation based upon a value twice or three times as much as the real value of the building" or on one-half of its value if the building has appreciated. The basis is cost. It is assumed here that the reorganized debtor is legally entitled to the same depreciation basis as its predecessor, absent any question of debt reduction or cancellation. This relation of the depreciation basis to the actual value of the property may be utterly immaterial on the question of the debtor's right to use it. What the debtor is entitled to, in such circumstances, is the return of the capital represented by the amount of the depreciation basis, altogether irrespective of whether this is less than, equal to, or in excess of the actual value of the property. To hold otherwise is to turn capital invested into income and an income tax into a capital levy. See page 14 hereof.

The Court seems to think there is something inherently wrong in a company's retaining a depreciation basis higher than the actual value of the property, and this, too, no matter how the excess resulted, no matter how truly the depreciation basis may represent the undepriciated cost of the property to the company. This, the court calls "a fictitious depreciation basis". Such a view displays, we submit, a wholly erroneous concept of depreciation. Until

the taxpayer has had his capital returned to him, its cost, less depreciation, is the true basis, however much this may, at the time, exceed the actual value and the revenue act is drafted on this theory.

One of the first principles of income tax law, furthermore, is that changes in value of a taxpayer's property are not recognized until they are reflected in some definite taxable transaction, such as a sale of the property. If the principle which the Court adopts should be applied generally, the result would be revolutionary. A taxpayer could successfully claim a loss whenever one of his assets had diminished in value. A profit might be claimed on unrealized appreciation.

The court below also says:

... Sections 268 and 270 are complementary. Section 268 relieves the debtor corporation of a tax on any of its income represented by the cancellation of an indebtedness in a reorganization proceeding under Chap. X. *We must read Section 270 in the light of this Sec. 268 tax exemption.* (Italics ours.)

Debtor reorganization under the Bankruptcy Laws nearly always results in a reduction of the outstanding indebtedness. In fact, reorganizations are for the avowed purpose of avoiding the evil effects of overindebtedness. This accomplished, when the reorganizations are in good faith, by reduction or the elimination of all or a part of such debt burden.

"Such a reduction of the debt of the reorganized debtor, however, might result in a so-called profit to the corporation. This occurs by reason of the lessening, or extinction, of its debt. By Section 268, Congress provided for this contingency and relieved the debtor from an income tax on such a possible charge of profits. On the other hand, were it not for Section 270, the debtor would profit unfairly. It would continue a depreciation base for tax purposes that is out

of line with its actual value. It would be getting a benefit, which it should receive, under Section 268, but at the same time it would evade its taxes in so far as they reflected a false and exaggerated depreciation base.

But the Court did not give effect to this dependence of Sec. 270 on Sec. 268 in reversing The Tax Court on the point above mentioned. If it had, its decision would have been the other way. Section 268 did not exempt any income here.

A bondholder who invests \$1000. in a bond makes no profit when he exchanges it for stock in a 77B case. He cannot deduct any loss if it is a nontaxable reorganization as this was. (Sec. 112 (b) (3); R. C.) A corporation which transfers its property to another corporation for its stock makes no profit because the property is the subscription price of the stock and if the transfer is in a reorganization, as defined in the revenue act, which the Tax Court held this was, there is no recognizable loss of profit.

The opinion of the court below assumes the major premises upon which it rests. It begs the questions. It rests on the assumption that the old corporation made a profit which would have been taxable to it but for section 268. This is not so. When this assumption falls, the opinion below falls with it.

Furthermore, the construction placed upon the Act by the court below creates a great discrimination between 77B and other reorganizations.

The Court speaks of the Claridge Apartments Company "getting a benefit, which it should receive, under Sec. 268, but at the same time (evading) its taxes insofar as they reflected a false and exaggerated depreciation base". In what way, or in what amount, it may be asked, could the

income tax liability of Claridge Apartments Company have been increased in 1935 (the year of the reorganization) as a result of the substitution of stock for bonds? *No debt had been written down or canceled in the sense that such change would create income tax liability under the doctrine of the Kirby Lumber Company case or under the taxing statutes.*

The Court is on no sounder ground when it undertakes to find the reason for the enactment of Sec. 270 and to apply it as a support to the construction of the Section given. It says:

"The financial crash of '29 caused values of real estate and buildings thereon to tumble. The Chandler Act deal with the reorganization of companies which held such properties. It dealt with debtors that had outstanding mortgages and other indebtedness in excess of the value of their real properties. When the reorganization of these debtors was completed, in many instances the indebtednesses were greatly reduced or cancelled. In the instant case the debt was entirely eliminated. In place thereof, stock of much less market value than the face value of the debt, was issued."

Whatever the reasons for the enactment of the Chandler Act the reasons for the insertion in it of 268 and 270 appear in the Committee Hearings and the Committee report to which the court below does not refer (See note 1 hereof).

The court below quotes an opinion of this court that capital stock is not a debt (R. 232). This is another false issue. No one asserts it is a debt. The Tax Court said one liability was substituted for another in this transaction. The word liability is much broader than the word debt and capital stock is a liability. See *Commissioner v. Capento Securities Co.* (C. C. A. 1st), published in C. C. II, 1944

Tax Service, Paragraph 9170. A corporation owes many duties to its stockholders.

If the 77B proceeding had not been a non-taxable reorganization (the tax Court held it was and respondent did not appeal) the bondholders of the debtor, who received stock, could have charged off their loss and it would be wrong for them to again get the benefit of the loss thus charged off, in depreciation deductions. This would be a double benefit. Also, the debtor corporation would have sustained a recognizable loss. However, the Tax Court found a non-taxable reorganization took place and, as pointed out on page 14 hereof, neither the bondholders nor stockholders nor the debtor corporation could deduct any loss.

The court below says:

"Finally, if we give the same effective date of application to both Sections 268 and 270, we are dealing with realities, with facts as they are. We are relieving an involved debtor from an income tax on a profit which it did not make when its debts were reduced; and we are asking it to figure its depreciation on a basis which accords with the facts, not with figures that are fictional and have no connection with values of today. Why should we attribute to words of a statute a meaning which would continue to make believe, water values that were wrung out of them in the reorganization proceedings."

If, as the court below says, the debtor did not make a profit there was no income tax to relieve it of. Furthermore, there are no "water values" involved. Every dollar paid for the bonds was used to erect the building and so far as the investors were concerned every dollar of their money was still in that building when they reorganized it.

Also, the cost to the corporation of the building (cost basis for depreciation) had not diminished.

Also, section 268 did not relieve the debtor from any tax because in a non taxable reorganization, such as we have here, section 112 (b) (4) of the I. R. C., which existed years before the Chandler Act and now exists, expressly provides:

"(4).—Same.—Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization solely for stock or securities in another corporation a party to the reorganization."

Since the court below holds section 270 was intended to compensate for tax lost because of section 268, it should have affirmed the Tax Court because section 268 did not relieve the debtor from any tax.

Consider the absurd consequences of the decision below. You invest \$500,000. in all the bonds of a corporation and it builds an apartment house with this \$500,000. Values shrink in a depression and you exchange your bonds for stock worth \$100,000. at market but the transaction, being a non taxable reorganization, neither you nor the old or new corporation realizes any profit or loss. A boom time comes and the new corporation sells the building for cost less depreciation, say for \$350,000. Under the holding of the court below it has a taxable profit of \$250,000. You can never recover your investment. The effect is to tax the capital invested by you as income. It is submitted Congress never intended such absurd results. The situation it sought to reach is the one contained in the example given by Kent and mentioned in note 1, at page 9 hereof. Furthermore, the construction of the court below creates

an indefensible discrimination between 77B and other reorganizations.

II.

Section 270 is not retroactive so as to affect tax liability prior to the year of its enactment.

The words of the Statute are (Appendix 23):

"(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date."

The court below quotes these words in its opinion and states:

"Given their ordinary meaning the words 'before the effective date of this amendatory Act' mean that if the Act applies to reorganizations which were completed before June 22, 1938."

In so holding the court below decided a false issue not present in this case and not in dispute.

Of course, the Act applies to 77B plans confirmed before its enactment. Everyone admits that and it was not even an issue in this case.

The decision of the Tax Court in this case was that it applied to this plan although confirmed before the Act was passed. That is the most the Act says. It does not say it applies retroactively in computing tax liability or that it applies in computing the tax liability for years prior to the year of its enactment. It merely means that from the year of its enactment it applies in computing tax liability of any plan confirmed before the effective date of the

amendatory Act". (Whether the Statute limits this to pending cases is discussed on page 20 hereof.)

A reading of the opinion of the court below discloses it does not touch this issue. It decides a false issue—a point conceded by all and assumes it determines the case.

In a very carefully considered opinion in *The Commodore* 46 B. T. A. 717 at page 723, the Board of Tax Appeals quoted the report of the Senate Judiciary Committee that section 2270 applies "for future tax purposes" and so held, as it also held in the case at bar. The Board was affirmed in *The Commodore* case by the Sixth Circuit in 135 F. (2d) 89 and this case conflicts therewith.

The provisions of the Chandler Act do not apply to proceedings pending when it was enacted with three exceptions applicable only to pending proceedings.

The Tax Court correctly held the Chandler Act applied to plans confirmed before its enactment but applied to them prospectively only but failed to notice that for it to apply to such plans the proceeding must have been pending when it was enacted.

The Tax Court overlooked that the Chandler Act did not apply to pending proceedings except with three specific exceptions—all of which referred only to pending proceedings. (For statute see Appendix, page 22.)

In the case at bar the plan was confirmed May 14, 1935 (R. 187) and final decree was rendered March 1, 1937 (R. 187). The proceeding was not pending when the Chandler Act became law on September 22, 1938.

The point we raise here is not a question of tax law but purely one of statutory construction.

Section 276 c (Appendix 22) declares:

c. the provisions of section 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that . . .

The three exceptions which follow, (1), (2) and (3), are all keyed to the above quoted general rule, *which refers only to pending proceedings*. Exception (3) therefore means sections 268 and 270 apply to any plan confirmed before its enactment if the proceeding was pending when it was enacted. In other words, the statute says it does not apply at all to pending proceedings except if the proceeding is pending then sections 268 and 270 apply to it.

If the proceeding was pending a plan confirmed two years previously could be vacated and reformed so as to give the greatest possible relief to the bankrupt and thus any unfairness of retroactivity could be avoided in such case and a taxpayer could not say, "If the rule had been in force I would have played differently."

The writ should be granted and the Tax Court's decision affirmed on the points of non retroactivity and non correlation of debt.

All of which is respectfully submitted.

JOHN E. HUGHES,

WALTER HAMMILLON,

CORNELIUS E. LOMBARDI,

JESSE ANDREWS.

Counsel for Petitioner.

APPENDIX.

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification, in or cancellation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter.

(U. S. C. 1940 ed., Title 11, Sec. 668.)

Sec. 269. Where it appears that a plan has for one of its principal purposes the avoidance of taxes, objection to its confirmation may be made on that ground by the Secretary of the Treasury, or, in the case of a State, by the corresponding official or other person so authorized. Such objections shall be heard and determined by the judge, independently of other objections which may be made to the confirmation of the plan, and if the judge shall be satisfied that such purpose exists, he shall refuse to confirm the plan.

(U. S. C. 1940 ed., Title 11, Sec. 669.)

Sec. 270. [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money, as is

transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income tax purposes and otherwise carry into effect the purposes of this section.

(U. S. C. 1940 ed., Title 11, Sec. 670.)

Sec. 276.

c. the provisions of section 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that:

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings;

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient.

(U. S. C. 1940 ed., Title ii, Sec. 676.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934, as amended by T. D. 4871, 1938-2 Cum. Bull. 130, and T. D. 5003, 1940-2 Cum. Bull. 107.

Art. 113 (b)—2. Adjusted basis: Cancellation of indebtedness.—In addition to the adjustments provided in section 113 (b)(1) and article 113 (b)—1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any proceeding under section 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B or under Chapter X, XI, or XII of the Bankruptcy Act of 1898, as amended.

For the purposes of this article—

(A) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(B) Except where the context otherwise requires, property means all of the debtor's property other than money;

(C) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return;

(D) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay; and

(E) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which said indebtedness shall have been canceled or reduced.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this article.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this article.

Article 113 (b) — 2, Treasury Regulations 94, as amended by the same Treasury Decision, is identical with the above quoted article.

FILE COPY

IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

No. [REDACTED] 28

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

SUPPLEMENTAL MEMORANDUM FOR PETITIONER

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

No. 701

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

SUPPLEMENTAL MEMORANDUM FOR PETITIONER

May It Please The Court:

This supplemental memorandum is filed because, since the filing of the petition, the Revenue Act of 1943 has been passed over a veto.

Section 121 (c) of that Act repeals the sections of the Chandler Act here involved but such repeal does not affect any tax year beginning prior to January 1, 1943.

Hence, all reorganizations under 77B and Chapter X of the Chandler Act leave this question open since the

depression until 1943 and therefore its importance is patent and it should be settled by this court.

Section 121 was inserted in the 1943 Act by the Senate, a majority of the members of which was composed of the same persons who composed a majority of the Senate adopting the Statute at bar. Their present action indicates they never intended the sections at bar to operate as the court below says they intended.

In his recent speech Senator Barkley said whether sections 121 and 122 of the 1943 Act would be needed would depend on the outcome of cases now in the courts.

ST. L. ed. at pages 817, 818 has a note supporting our contention that no income was realized in the reorganization for the Chandler Act to free from tax.

All Of Which Is Respectfully Submitted,

JOHN E. HUGHES,

Counsel for Petitioner.

No. [REDACTED]

29

IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SEVENTH CIRCUIT AND BRIEF
IN SUPPORT THEREOF.**

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SUMMARY OF MATTER INVOLVED.

The matter involved is the action of Tax Court of United States in finding the cost of the building in question was \$385,326.37 instead of \$424,609.19 as shown by uncontradicted documentary and oral evidence by credible and unimpeached witness and with no evidence whatever to support such reduction. This is in finding the basis of depreciation of a large apartment building of the taxpayer. This question was not decided by the United States Circuit Court of Appeals for the Seventh Circuit as it became moot because it reversed the Tax Court on other points but it will become a vital issue if the Supreme Court of the United States reverses that Court in companion Petition for writ of certiorari.

The Tax Court of the United States also admittedly without any evidence to support it, found \$80,022.20, defaulted interest had been taken as a tax benefit, admittedly without any evidence to support its finding and with that not being an issue in the case. It also lowered the rate of depreciation taken for 10 years without that being an issue. It also disallowed a deduction for painting and repairs with no evidence to support it. Such rulings are not due process of law

BRIEF.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

*To the Honorable, the Chief Justice and Associate Justices
of the Supreme Court of the United States:*

Claridge Apartments Company, a corporation, the petitioner in above entitled cause, by John E. Hughes, Walter Hamilton, Jesse Andrews and Cornelius E. Lombardi, its attorneys, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals, for the Seventh Circuit of date December 1, 1943, affirming the Tax Court of the United States in case No. 8296.

Summary and Short Statement of the Matter Involved.

On January 17, 1941, the Commissioner of Internal Revenue made a deficiency assessment against petitioner for \$3,289.74 income taxes and \$67.85 for excess profits for the years 1935 to 1938 inclusive (Rec. 7). The chief ground of the assessment was that the basis of depreciation for this period should be the fair market value of its large apartment building, on the date of its acquisition by the taxpayer, Aug. 1, 1935, or \$132,500, instead of its cost, \$424,609.19. The ground asserted was that petitioner was not the result of a tax-free reorganization (Rec. 9, 12, 15, 16, 18). Appeal was taken to the Board of Tax Appeals (Rec. 3). Just prior to trial this court handed down decisions in four important cases, bearing on the question which weakened Commissioner's case materially. Commissioner, without amending his pleading, asserted orally at the trial he was relying on Section 270 of the Chandler Act for his position as well, that the fair market value of the building was the correct basis of depreciation (Rec. 23). Nothing was then asserted or claimed that defaulted interest had been taken as a tax benefit by petitioner's transferor on income tax reports.

Helvering v. Alabama Asphalt Limestone Co.
315 U. S. 179.

Palm Springs Holding Corporation v. Commissioner, 315 U. S. 485.

Bondholders Committee, Marlborough Investment Co. v. Commissioner, 315 U. S. 189.

Helvering v. Southwest Consolidated Corporation
315 U. S. 194.

The Tax Court of the United States found there was a tax free reorganization (Rec. 194) under Section 113. Section 270 of the Chandler Act was not retroactive but applies to this case as to income taxes for the year 1938.

that petitioner exchanged 2770 shares of its common stock of no par value in the reorganization for \$277,000 face value of first mortgage bonds of its transferor which was insolvent and took title to all its property on Aug. 1, 1935; this was not a cancellation or reduction of debt within the meaning of Section 270 of the Chandler Act as the assets of the Company were still subject to a capital stock obligation (Rec. 198); that there was no evidence to support the finding that \$80,022.20 of defaulted interest had been taken as a tax benefit by petitioner's transferor but it so found and deducted that sum from the cost of the building (Rec. 198); that the cost of the building was \$385,326.37 instead of \$424,609.19 (Rec. 184, 198), though the uncontradicted and unimpeached documentary and oral evidence, proved the latter sum and it had been asserted by the petitioner and its transferor without challenge in its income tax reports for 15 years; that the adjusted cost of the building on August 1, 1935 (Rec. 190) was \$239,377.33 which finding arbitrarily changed the rate of depreciation from 1925 to 1935 without that point being at issue and with no evidence to support it (Rec. 190); and it disallowed \$1,294.40 for painting and decorating, and \$389.60 for repairs on the income tax report of 1937 on the ground it had previously been allowed in 1936. The testimony of Charles F. Henry that there had been no such duplication is uncontradicted. On appeal the commissioner admitted there was a tax free reorganization under Section 112 of Revenue Act of 1934 and relied wholly on Section 270 of the Chandler Act. The United States Circuit Court of Appeals for the Seventh Circuit on appeal from the Tax Court by the Commissioner in Case 8297 reversed it, holding Section 270 of the Chandler Act was retroactive and covered the years 1935 to 1938 inclusive, though the date it became in force was Sept. 22, 1938, and that exchange of \$277,000 face value of first mortgage bonds in

this reorganization for 2770 shares of capital stock without par value in petitioner was a cancellation or reduction of indebtedness, within the meaning of Section 270 of the Chandler Act; that the value of the stock received on August 1, 1935 was \$45.00 per share, that the consequent reduction of the indebtedness was \$55.00 per share or \$152,350; this sum was below the fair market value of the building on May 14, 1935, the date the plan was approved, or \$141,000. Therefore since the reduction or cancellation was more than the fair market value of the property, the latter, \$141,000, should be the basis of depreciation in figuring the income taxes for 1935 to 1938 inclusive.

It then held moot the questions raised by petitioner in its appeal in Case 8296, except the question of alleged duplication of deductions for decorating and repairs for the year 1937 (Rec. 237, 231).

It found there was some evidence to support the Tax Court as to the latter and affirmed it. It also affirmed the Tax Court on the other questions on the ground that they were moot but without deciding these questions on the merits (Rec. 237).

The petitioner has filed a separate petition for certiorari to the Court covering the judgment of the Circuit Court of Appeals for the Seventh Circuit in reversing the Tax Court in Case 8297.

The questions held moot by the Circuit Court of Appeals for the Seventh Circuit were as follows:

(1) Whether the Tax Court of the United States erred as matter of law in finding the cost of the building in this case was \$385,326.37 instead of \$424,609.19, when the latter contradicted documentary evidence and oral evidence.

proved the latter value, especially as that value was asserted by the taxpayer and its predecessor in title for 15 years in its income tax reports without challenge by the commissioner.

(2) Whether the Tax Court of the United States erred as a matter of law in finding that \$801,222.29 defaulted interest was taken as an income tax benefit by the transferor of petitioner when the Tax Court admits there is no evidence to support such a finding, the question was not at issue by the pleadings, or evidence, and all the facts and circumstances showed such sum was not taken as such benefit.

(3) Whether the Tax Court of the United States erred as a matter of law in its finding that \$239,377.33 was the correct adjusted basis for depreciation when that finding changed the rate of depreciation taken and allowed for 10 years by petitioner when that issue was not raised by the pleadings, evidence or contention of the parties.

If the Court allows Petition for certiorari in regard to the case 8297 and holds Section 270 of the Chandler Act has no application to a tax free reorganization as we claim then necessarily the Circuit Court of Appeals for the Seventh Circuit or this Court should decide the three alleged moot questions as in that case they would no longer be moot. It is submitted therefore that this petition should not be decided by this Court until it decides our Petition in Case No. 8297 and if it decides that petition in our favor, the Court should decide this petition or remand the case to the Circuit Court of Appeals for the Seventh Circuit to decide these three questions on the merits.

It is necessary for petitioner to file this petition because of the decision of the Circuit Court of Appeals in affirming

the Tax Court of the United States on these two questions which became moot in order to avoid a claim that we acquiesced in this decision.

Opinions Below.

The opinion of the Tax Court of the United States is found in 1 T. C. 163 (1943) (Rec. 183). The opinion of the Circuit Court of Appeals for the Seventh Circuit is found in 138 F. 2nd 962, (1943) and in (Rec. 228).

Jurisdiction.

The judgment of the Circuit Court of Appeals for the Seventh Circuit was entered Dec. 1, 1943 (Rec. 237), and the petition for rehearing was denied December 22, 1943 (Rec. 238). The jurisdiction of this Court is invoked under Section 240 (2) of the Judicial Code, as amended by Act of Feb. 13, 1925 (28 U. S. C. A. Section 347 a).

The Questions Presented.

(1) Did not the Circuit Court of Appeals for the Seventh Circuit err in affirming the Tax Court of the United States as a moot question in deducting \$38,532.64 from the cost price of the building in this case of \$424,609.19, without any evidence to support such action and in not holding that \$424,609.19 was the cost price thereof when there was no proof produced to offset the documentary and unimpeached and uncontradicted parol evidence that such was the cost and such evidence is corroborated by its assertion in the income tax return of the transferor of petitioner the next year after it was built and for 14 succeeding years without challenge by the commissioner?

(2) Did not the Circuit Court of Appeals for the Seventh Circuit, err in not holding that the question of whether

the defaulted interest on the first mortgage bonds, amounting to \$80,022.20 was taken as a tax benefit on income tax reports, and therefore to be deducted from the cost price of the building, was not at issue under the pleadings in the case, no evidence was introduced by either side in regard thereto and what evidence was in the case showed such interest was not taken as a tax benefit, and therefore the Tax Court of the United States committed error in deducting this sum from amount of the cost of the building in arriving at the basis of depreciation?

(3) Did not the Circuit Court of Appeals for the Seventh Circuit, err in not holding the Tax Court of the United States erred in holding a different rate of depreciation for the building of the taxpayer should be taken from 1925 to 1933, than that taken for 15 years without objection of commissioner when that point was not at issue in the case and no evidence was offered by either side?

(4) Did not the Circuit Court of Appeals for the Seventh Circuit err in not holding the Tax Court of the United States erred in not holding there was no evidence that items of painting and repairs taken in the 1937 return of the taxpayer were a duplication of 1936 deduction, and the only evidence was that there was no such duplication and it was uncontradicted.

Statutes and Regulations Involved.

The Statutes and Regulations involved are set forth in the Appendix.

Reasons relied on for the allowance of the writ of certiorari.

(1) The decision of the Circuit Court of Appeals for the 7th Circuit in affirming the Tax Court of the United States in this case on the ground the question was moot, as to whether commission of the builder was improperly disallowed as a part of the cost of the building becomes erroneous if certiorari is granted from the decision of the Circuit Court of Appeals for the Seventh Circuit reversing the Tax Court of the United States and the Court reverses such decision. Such finding is based on no evidence whatever and is contrary to the unimpeached, undisputed, documentary and oral evidence. Correctness of the cost claimed is further corroborated by its acceptance by the commissioner without question for 15 years from 1925 to 1940 in the income tax reports of petitioner and its transferor. It was error of law to make this deduction, and a denial of due process of law.

It is well known that among the American Bar, there is general dissatisfaction that government agencies tend to disregard legal rules and principles in making decisions. They should be guided by decisions of the Supreme Court of the United States. It is not due process of law within the meaning of the Federal Constitution to try cases without observing the law.

(2) The decision of the Circuit Court of the United States in deducting \$80,022.20 defaulted interest on bonds from the cost price of the building is erroneous if the court decides with us in Case 8297. There was admittedly no evidence for such a finding because no evidence was offered to prove this interest was used as a tax benefit and this issue was not raised by the pleadings or urged by the Commissioner in the Tax Court of the United States.

(3) The Decision of the Circuit Court of Appeals for the 7th Circuit in not passing on the ruling of the Tax Court of the United States in changing the rate of depreciation on the cost of the building from that taken and allowed by the commissioner for 15 years is erroneous if the Petition for certiorari is decided in our favor in case No. 8297. This question was not at issue by the pleadings and no evidence was offered by either side on it.

(4) The Decision of the Circuit Court of Appeals for the 7th Circuit in affirming the decision of the Tax Court of the United States in disallowing deductions for painting and repairs for the year 1937 is erroneous as unsupported by any evidence whatever.

Wherefore petitioner respectfully prays that a writ of certiorari be issued out of and under the Seal of this Honorable Court directed to the Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this court on the date designated in said writ full and complete transcript of record of all proceedings in the case entitled *Claridge Apartments Company, an Illinois Corporation v. Commissioner of Internal Revenue*, No. 8297, to the end that said case may be reviewed and determined by this Court as provided by law and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem proper.

CLARIDGE APARTMENTS COMPANY, a
corporation.

By JOHN E. HUGHES,

WALTER HAMILTON,

JESSE ANDREWS,

CORNELIUS E. LOMBARDI,

Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions of the Court Below.

The Petition of the Taxpayer prevailed in part and was overruled in part by the Tax Court. The opinion is found in 1 T. C. 163 (1943) and (Rec. 191).

The Commissioner prevailed in the Circuit Court of Appeal for the 7th Circuit. The opinion is found in 138 F. 2d 962 (1943) and (Rec. 228).

Jurisdiction.

1. The jurisdiction of this Court is invested under Section 240 (a) of the Judicial Code as amended by Act of Feb. 13, 1925, 43 Stat. 938, 28 U. S. C. A. Section 347 (a).

2. The date of the judgment of the Circuit Court of Appeals of the Seventh Circuit herein sought to be reviewed, is Dec. 1, 1943, and petition for rehearing was denied December 22, 1943.

Statement of the Case.

On January 17, 1941, the Commissioner made a deficiency assessment of income tax liability amounting to \$328,974 and \$67.85 for excess profits taxes for the years 1935 to 1938 inclusive (Rec. 7).

The chief ground of assessment was that the basis of depreciation of taxpayer was the fair market value of the large apartment building of the taxpayer, on Aug. 1, 1935, of \$132,500 as it was not a tax free reorganization (Rec. 9, 12, 15, 16, 18). On April 11, 1941, the taxpayer filed petition for redetermination of this assessment before the Board of Tax Appeals (Rec. 3). The chief ground of the petition was that taxpayer was the result of a tax free reorganization and the cost of the building to the transferor company of \$424,609.49 was the correct basis of depreciation (Rec. 3, par. A, B, D.).

The commissioner denied this was the proper basis and asserted the fair market value on date of acquisition Aug. 1, 1935, was the correct basis, on the ground it was not a tax free reorganization (Rec. 21, par. 4 A, B, C, 10, 12, 15, 16, 18). Just before the case was tried this case handed down four important decisions which made it

claims of the commissioner very thin. Consequently at the trial without amending the pleadings, counsel announced he was going to rely on Section 270 of the Chandler Act as well for his contention that the fair market value of the building was the correct basis of depreciation.

No claim was made orally or in writing that defaulted interest on 1st mortgage bonds was taken as a tax benefit by the taxpayer. The Tax Court found there was a tax free organization (Rec. 194); that section 270 did apply to the reorganization for the year 1938 and was not retroactive to the years 1935 to 1937 inclusive (Rec. 195, 196); that the words "cancelled or reduced", in Section 270 did not apply to an exchange of bonds for stock in a new company because the assets of the company were not freed from obligation but merely a capital stock liability was substituted for a debt obligation; that the cost of the building was \$385,326.37 instead of \$424,609.19, which had been taken as a basis of depreciation for 15 years (Rec. 184, 198); that there was no evidence in the record whether \$80,022.20 of defaulted interest was taken as a tax benefit by the taxpayer and this question was not at issue in the case either by the pleadings or evidence, but it deducted this sum from the cost of the building as a basis for depreciation and arbitrarily changed the rate of depreciation from 1925 to 1935 without any evidence to guide it and without this being an issue in the case (Rec. 197). It also disallowed certain deductions for 1937 for repairs and painting, without any evidence to support its finding.

The Circuit Court of Appeals for the Seventh Circuit, held Section 270 of the Chandler Act was retroactive and applied to the years 1935 to 1938 inclusive; that an ex-

¹ Helvering v. Alabama Asphaltic Limestone Co., 315 U. S. 179, Palm Springs Holding Corporation v. Commissioner, 315 U. S. 183, Bondholders Committee, Marlborough Investment Co. v. Commissioner, 315 U. S. 189, Helvering v. Southwest Consolidated Corporation, 315 U. S. 194.

change of bonds for stock was a cancellation within the meaning of Section 270 and the amount to be deducted from the cost of the building as adjusted was the difference between \$277,000 face of the bonds, and the fair market value of the 2770 shares of stock received in exchange for the bonds; it found the fair market value was \$45.00 per share. This deduction from the cost even of \$424,609.19 as adjusted would bring the value of the building below \$143,000, which was the market value of the building on May 14, 1935, the date the plan was approved. It held \$141,000 should be taken as the basis of depreciation, as of May 14, 1935. It also affirmed the Tax Court of the United States in disallowing deductions of painting and repairs for 1937. It affirmed the Tax Court on the points appealed by the taxpayer in case No. 8296, and reversed the Tax Court in all points of the appeal in case No. 8297. In the Circuit Court of Appeals for the Seventh Circuit, the commissioner in his brief conceded it was a tax free reorganization within the meaning of Section 112 of the Internal Revenue Act of 1934.

The Claridge Building Corporation built a large apartment building in 1924 (Rec. 24, 25, 219). On March 25, 1925, it issued 1st mortgage bonds of \$349,000 (Rec. 75). On Oct. 1, 1931 foreclosure proceedings were started for non payment of interest (Rec. 76). The principal amount of bonds then due were \$277,000 (Rec. 76). A decree of sale was had (Rec. 76). Then a reorganization was had at the instance of 93 per cent of the bondholders and all the stockholders (Rec. 75) in C.B. proceedings whereby bondholders exchanged 277,000 face value of bonds for 2770 shares of stock of no par value in Claridge Apartments Company (Rec. 76). Stockholders of Claridge Building Corporation obtained 10 per cent or 308 shares of stock in Claridge Apartments Company (Rec. 75). All the prop-

erty of Claridge Building Corporation was transferred to Claridge Apartments Company (Rec. 77, Par. 1; Rec. 79, Par. 4 and (a) (b) (c) (d); Rec. 80, 40, 81, 182).

Assignment of Errors.

1. The Circuit Court of Appeals for the Seventh Circuit erred in affirming finding of Tax Court of the United States that the cost of the building in this case was \$385,326.37 instead of \$424,609.49 as the uncontradicted and unimpeached documentary and oral evidence showed.

2. The Circuit Court of Appeals for the Seventh Circuit erred in affirming judgment of the Tax Court of the United States deducting \$80,022 defaulted interest from the cost price of the building in this case when there was no issue on this question in the pleadings or evidence and admittedly absolutely no evidence supports such a finding.

3. The Circuit Court of Appeals for the Seventh Circuit erred in affirming decision of the Tax Court of the United States, changing the rate of depreciation of the building in this case over a period of ten years that had been allowed by the commissioner, without the rate of depreciation for that time being an issue in the pleadings or evidence and no evidence of any kind supports such a finding.

4. The rulings of the Tax Court of the United States in (1), (2) and (3) of this assignment of errors denies to petitioner due process of law in violation of Article V of the Constitution of the United States.

5. The Circuit Court of Appeals for the Seventh Circuit erred in disallowing deductions for painting and repairs for the tax year of 1937 as the uncontradicted evidence showed these items were proper deductions.

ARGUMENT

Summary.

I.

There was no evidence whatever warranting the Tax Court of the United States to reduce the cost of the building from \$424,609.19 to \$385,326.37.

(a) When there is absolutely no evidence in the record to support a finding of the Tax Court of the United States or no substantial evidence to support it, it is an error of law for the Tax Court of the United States to make this finding. There is no evidence in the record to support the finding that \$385,326.37 was the cost of the building at 4501 Malden St., Chicago, Illinois.

P. C. Tomson & Co., Inc. v. Com., 82 Fed. Rep. (2d) 398 (C. C. A. 3rd Cir. 1937), p. 398.

Foster v. Com., 57 Fed. Rep. (2d) 516 (C. C. A. 5th Cir. 1932), p. 518.

Griffin Brush Co. v. Blair, 32 Fed. Rep. (2d) 42 (C. C. A. 4th Cir. 1929), p. 44.

Nichols v. Com., 44 Fed. Rep. (2d) 157 (C. C. A. 3rd Cir. 1930), p. 159.

(b) When unimpeached documentary evidence and verbal testimony, uncontradicted, credible, and not impeachable, are introduced, the Tax Court of the United States cannot disregard it but must accept it as true. The original entry and the testimony of Charles E. Harkins show the cost of the building at 4501 Malden St., Chicago.

to be \$424,609.19. They are unimpeached, the evidence is credible, and not improbable.

Boggs & Buhl, Inc. v. Com., 34 Fed. Rep. (2d)

859 (C. C. A. 3rd Cir. 1929), pp. 860, 861.

Pittsburgh Hotel Co. v. Com., 43 Fed. Rep. (2d)

345 (C. C. A. 3rd Cir. 1930), p. 347.

(c) The United States Government, though a sovereign, when it litigates with a private citizen is estopped to make assertions just as private individuals are estopped, when equity requires it. For 15 years petitioner and its predecessor, reported the cost of its building to be \$424,609.19 in its income tax returns. For 15 years respondent accepted this valuation when he could have demanded proof. He is now estopped to question this valuation.

State of Illinois v. I. C. C. R. Co., 246 Ill. 188

(1910), p. 248.

State of Indiana v. Milk, 14 Fed. Rep. 389 (C. C.

D. Ind., 1882), pp. 396, 397.

U. S. v. Thelka, 266 U. S. 328 (1924), p. 339.

Halter v. U. S., 139 Fed. Rep. 409 (C. C. M. D.

Ma. 1906), p. 412.

II.

A Court has jurisdiction to decide only the issues presented by the pleadings. It cannot decide issues not presented by the pleadings. The Tax Court of the United States erred in finding that \$86,022.29 should be deducted from the cost price of the building as adjusted to find the basis for depreciation for income tax of 1938, on account of alleged use of defaulted interest on the bond issue by Claridge Building Corporation from 1931 to 1935 as provided in Section 270 of the Chandler Act because that issue was not presented by the pleadings. In the case, no

evidence was taken thereon by either party, and the decision of the Tax Court of the United States is wholly unsupported by any evidence. All the evidence in the case was to the contrary. Furthermore no issue was raised by the pleadings or the evidence as to the proper rate of depreciation of the building from 1925 to 1935. The Tax Court of the United States arbitrarily, without any evidence to support it, found that the cost of the building as depreciated on August 1, 1935 was \$239,377.33. The cost, using the original figure of \$385,326.37 as found by the Court, and the rate of depreciation allowed by the Commissioner for fifteen years would be \$246,082.66.

Reynolds v. Stockton, 140 U. S. 254 (1891), pp. 264, 266, 268.

J. P. Jorgensen v. Rapp, 157 Fed. Rep. 732 (Ct. Cl. A. 9th Cir. 1907), p. 738.

Munday v. Faid, 34 N. J. Law 418 (1871), p. 422.

III.

Insolvency once proved is presumed to continue until the contrary is shown. On Sept. 15, 1931, foreclosure proceedings were started against Claridge Building Corporation because of inability to pay interest on the first mortgage and taxes. From 1931 to August 1, 1935, no interest was paid on the first mortgage but the whole accrued sum of \$80,022.20 remained unpaid. \$13,000 of general real estate taxes remained unpaid during that period. Only \$8,000 was accumulated by the receiver during that period. Nearly \$13,000 per year of depreciation was allowable on its accounting. During all this time it was operated by Trustee Melvin L. Straus. The original presumption and these proved facts tend to show that it was not necessary to take credit for unpaid interest on income tax returns.

Cleage v. Lardly, 49 Fed. Rep. 436 (C. C. A. 8th Cir. 1906).

Adams v. State, 87 Ind. 573 (1882), p. 575.

Wachsmuth v. Penn Mutual Life Ins. Co., 147 Ill. App. 510 (1909).

IV.

The law is that if the Commissioner of Internal Revenue makes a finding of fact on substantial evidence, and no evidence is adduced to overcome this, it stands.

Where, however, the Commissioner of Internal Revenue made no finding of fact on the subject, it is error for the Tax Court of the United States to make one for him arbitrarily without any evidence. This it did as to \$80,022.20 deducted from basis of depreciation on account of supposed use of defaulted interest as tax benefit under Section 274 of Chandler Act. There is no presumption of fact in this regard in the absence of evidence. The presumption in favor of commissioner's finding is rebutted when the Tax Court makes a finding different from his.

City of Indianapolis v. Keeler, 167 Ind. 516, (1906), p. 527.

Andrews v. Commissioner, 135 Fed. Rep. (2d) 314 (C. C. A. 2d Cir. 2-31-43), p. 318.

V.

The finding of the Tax Court of the United States that \$1,291.44 of deprecating and \$389.60 of repairs were charged in the returns of the taxpayer for both 1936 and 1937 is not supported by any substantial evidence and therefore should be reversed.

VI.

The action of the Tax Court of the United States in arbitrarily making findings of fact with absolutely no evidence to support it and contrary to uncontradicted and unimpeached documentary and oral evidence and making findings on issues not presented by the pleadings, the evidence and the claims of the commissioner, denies to petitioner due process of law in violation of Article V of the Federal Constitution.

12th Corpus Juris, pp. 1190, 1191.

ARGUMENT.

I.

It was an error of law for the Tax Court arbitrarily and with no evidence to support it, to find the cost price of the building was \$385,326.37 instead of \$424,609.19.

(a) Petitioner's Exhibit 2 is a book of original entry which showed in detail the cost of the building to be \$424,609.19 (Rec. 219). Charles F. Henry, the builder, so testified and both are corroborated by that figure being reported in the income tax report of Claridge Building Corporation, the next year after the building was built, namely, 1925, and for 15 years thereafter without objection by the commissioner. This documentary evidence plus the uncontradicted, unimpeached oral evidence of Charles F. Henry renders the finding of the Tax Court error of law.

P. C. Tomson & Co., Inc. v. Com., 82 Fed. Rep. (2d) 398 (C. C. A. 3rd Cir. 1935), p. 398.

Foster v. Com., 57 Fed. Rep. (2d) 42 (C. C. A. 5th Cir. 1932), p. 518.

OrFibre Brush Co. v. Blair, 32 Fed. Rep. (2d) 42 (C. C. A. 4th Cir. 1929), p. 44.

Nichols v. Com., 44 Fed. Rep. (2d) 157 (C. C. A. 3rd Cir. 1930).

(b) When unimpeached documentary evidence and verbal testimony is not contradicted, is credible and not improbable, the Tax Court cannot disregard it, but must accept it as true.

Beggs & Bufl, Inc. v. Com., 34 Fed. Rep. (2d) 859 (C. C. A. 3rd Cir. 1929), pp. 860, 861.

Pittsburgh Hotel Co. v. Com., 43 Fed. Rep. 345 (C. C. A. 3rd Cir. 1930), p. 347.

(c) The United States Government though a Sovereign, when it litigates with a private citizen, is bound by all the equities that arise between litigating citizens including the equitable doctrine of estoppel. So it is estopped after accepting \$424,609.19 for 15 years as the cost of this property as a basis for depreciation, in income tax reports to assert differently now.

State of Illinois v. I. C. R. R. Co., 246 Ill. 188 (1910), p. 248.

State of Indiana v. Milk, 11 Fed. Rep. 389 (C. C. D. Ind. 1882), pp. 396, 398.

U. S. v. Thelka, 266 U. S. 328 (1924), p. 339.

II.

The Tax Court erred in deducting \$80,022.20 from the cost of the building for the purpose of obtaining a basis for depreciation on the theory such defaulted bond interest of the transferor of the property was taken as a tax benefit. It admitted there was no evidence to support such a ruling (Rec. 197), and the question was not raised by the pleadings (Rec. 9, 12, 15, 16, 18, 3, Par. 4 (a), (b), (c), Rec. 21, Par. 4 (A to H), Rec. 197).

(a) A decision of a Court outside the issues raised is void.

Reynolds v. Stockton, 140 U. S. 254 (1891), pp. 264, 260, 268.

J. P. Jorgenson v. Rupp, 357 Fed. Rep. 722 (C. A. 9th Cir. 1907), p. 728.

Mandan v. Fall, 34 N. J. Law, 418 (1871), p. 4.

(b) Claridge Building Corporation, on Oct. 1, 1931 was in default in paying interest on its bond issue and taxes so that foreclosure was started (Rec. 76). At that time it had no need to take the benefit of defaulted interest on its income tax returns because it could not even pay taxes and it had nearly \$13,000 it took as depreciation on its building (Rec. 93, 95). This condition once existing is presumed to continue in law especially as the depression lasted until 1935. During the period the defaulted interest was accumulating and it was in the hands of a Trustee all this time.

Clage v. Lardly, 149 Fed. Rep. 346 (C. C. A. 8th Cir. 1906).

Adams v. State, 87 Ind. 573 (1882), p. 575.

Wachsmuth v. Penn Mutual Life Ins. Co., 147 Ill. App. 510 (1909).

III.

The Tax Court erred in changing the rate of depreciation of the building from 1925 to 1935 in arriving at the basis of depreciatiton, Aug. 1, 1935, as \$239,377.33 (Rec. 190). If we used the cost price found by the tax court and the rate of depreciation of 3 per cent allowed for 45 years, the basis would be \$246,082.66. If we use the cost price of \$424,609.19 used for 15 years in income tax reports and the rate we used for 15 years, the basis on Aug. 1, 1935 would be \$272,617.29 (Rec. 125).

IV.

The Tax Court erred in not allowing deductions for decorations of \$1,291.44 and for repairs, \$389.60 for the year 1937. All the evidence was for allowance and none to the contrary (Rec. 31, 32, 68, 71).

The Tax Court of the United States violated the 5th Amendment of the Constitution of the United States giving to citizens the right of due process of law in thus deducting \$38,532.64 from the cost of the building in finding the basis of depreciation, when the undisputed and unimpeached documentary and oral evidence was to the contrary and there was not a syllable of evidence to support its finding; it violated this Article of the Constitution in lopping off \$80,022 from the cost price of the building on the theory a tax benefit had been taken for this amount by its transferor when that question was not at issue by the pleadings, evidence or contentions of counsel, and there is not a syllable of evidence to support this finding and all the reasonable probabilities are to the contrary; it violated the 5th Amendment to the Constitution in changing the rate of depreciation allowed for 10 years of 3 per cent without that action being in question in the case by pleadings, evidence, or contention of counsel. It violated this amendment in its ruling on the deductions for painting and repair where the uncontradicted evidence was to the contrary.

This violation of the Constitutional rights of the taxpayer is so plain and palpable that extended citation of authorities is unnecessary. I merely quote 12 Corpus Juris 1160, *et seq.*

As applied to judicial proceedings, due process of law means a law which hears before it condemns, which proceeds on inquiry, and renders judgment only after trial . . . a course of proceeding according to those rules and principles which have been established in our system of jurisprudence for the protection and enforcement of private rights. . . the administration of equal laws according to established

rules, not violative of the fundamental principles of private right by a competent tribunal having jurisdiction of the case and proceeding on notice and hearing."

Respectfully submitted,

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APPENDIX.

Section 112 (g) (1) (B) of Income Tax Law of the United States for year 1934. 26 U. S. C. A. p. 695 (a) Definition of Reorganization as used in this Section and Section 113.

(1) The term "reorganization" means . . . (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock . . . of substantially all the properties of another corporation."

"Section 112 (g) (1) (D) (2). The term 'a party to a reorganization' includes . . . both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

Section 112. Reorganization of Gain or Loss. . . .

(b) Exchanges Solely in Kind. . . .

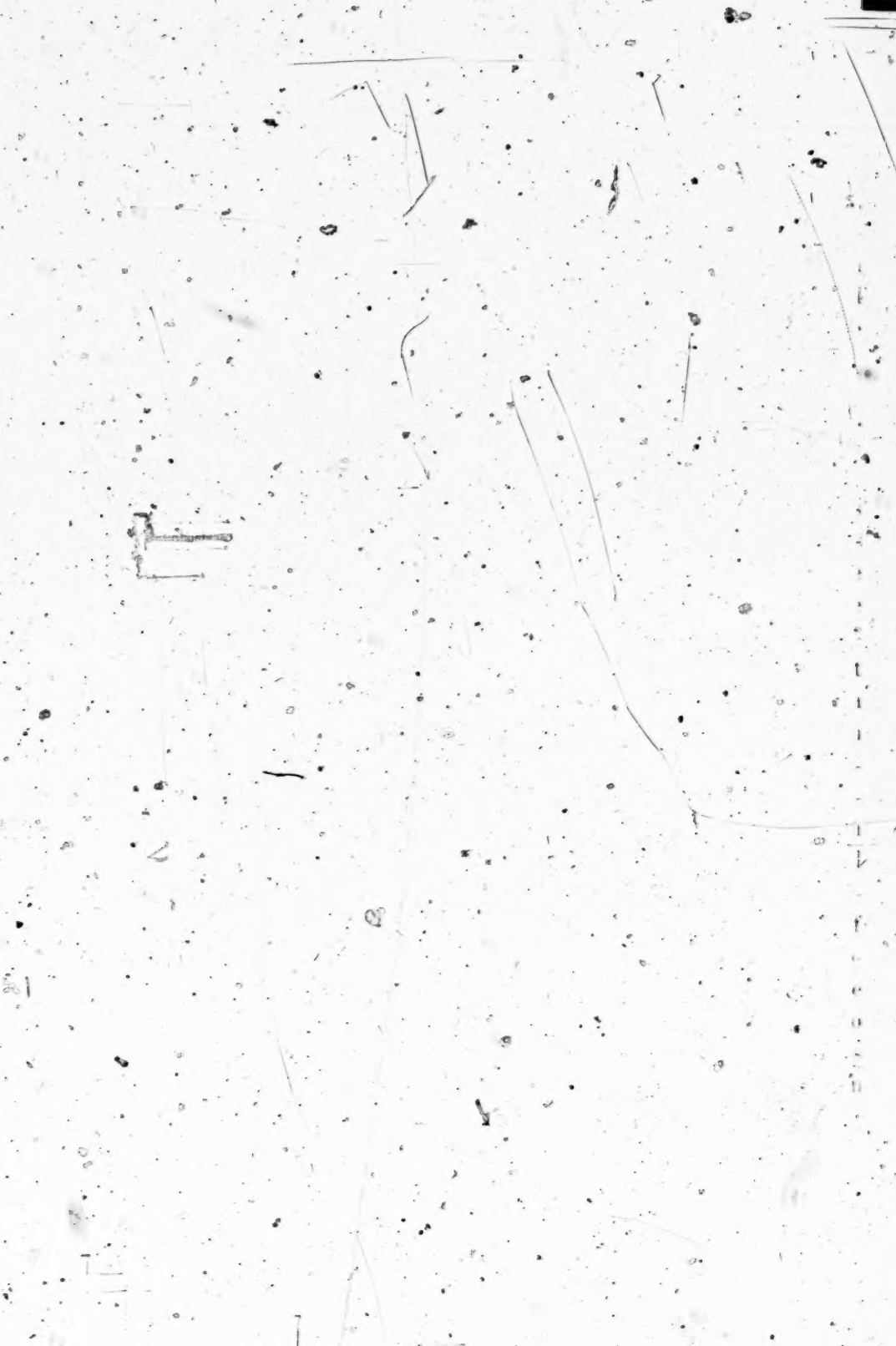
(3) Stock for Stock on Reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) Same.—Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanged property in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

Transfer to Corporation Controlled by Transferor.
—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; * * *

Section 113 (a) (6) Revenue Act of 1934 26 U. S. C. A.
p. 697.

(6) Tax free exchanges generally: If the property was acquired after February 28, 1913, upon an exchange described in 112b to e inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the Taxpayer and increased in the amount of gain or decreased in the amount or loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted in Section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it."



IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

No. **702**

29

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF OF PETITIONER.

JOHN E. HUGHES,
WALTER HAMILTON,
*Attorneys for Claridge Apartments
Company.*

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BRIEF OF PETITIONER.

Opinions of the Court Below.

The Petition of the Taxpayer prevailed in part and was overruled in part by the Tax Court. The opinion is found in 1 T. C. 163 (1943) and (Rec. 911).

The commissioner prevailed in the Circuit Court of Appeals for the 7th Circuit. The opinion is found in 138 F. 2nd 962 (1943) and (Rec. 228).

This court granted *certiorari* on the 27th day of March, 1944.

Jurisdiction.

1. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by Act of Feb. 13, 1925, 43 Stat. 938, 28 U. S. C. A. Section 347 (a).
2. The date of the judgment of the Circuit Court of Appeals of the Seventh Circuit herein sought to be reviewed, is Dec. 1, 1943, and petition for rehearing was denied December 22, 1943.

Statement of the Case.

On January 17, 1941, the Commissioner made a deficiency assessment of income tax liability amounting to \$3,289.74 and \$67.85 for excess profits taxes for the years 1935 to 1938 inclusive (Rec. 7).

The chief ground of assessment was ~~that~~ the basis of depreciation of taxpayer was the fair market value of the large apartment building of the taxpayer, on Aug. 1, 1935 of \$132,500.00 as it was not a tax free reorganization (Rec. 9, 12, 15, 16, 18). On April 11, 1941, the taxpayer filed petition for redetermination of this assessment before the Board of Tax Appeals (Rec. 3). The chief ground of the petition was that taxpayer was the result of a tax free reorganization and the cost of the building to the transferor company of \$424,609.49 was the correct basis of depreciation (Rec. 3, par. A. B. D.).

The commissioner denied this was the proper basis and asserted the fair market value on date of acquisition Aug. 1, 1935, was the correct basis on the ground it was not a tax free reorganization (Rec. 21, par. 4 A. B. C., 9, 12, 15, 16, 48). Just before the case was tried this Court handed down four important decisions which made the claims of

the commissioner very thin. Consequently at the trial without amending the pleadings, counsel announced he was going to rely on Section 270 of the Chandler Act as well, for his contention that the fair market value of the building was the correct basis of depreciation. *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U. S. 179; *Palm Springs Holding Corporation v. Commissioner*, 315 U. S. 185; *Bondholders Committee, Marlborough Investment Co. v. Commissioner*, 315 U. S. 189; *Helvering v. Southwest Consolidated Corporation*, 315 U. S. 194.

No claim was made orally or in writing that defaulted interest on 1st mortgage bonds was taken as a tax benefit by the taxpayer. The Tax Court found there was a tax free organization (Rec. 194); that section 270 did apply to the reorganization for the year 1938 and was not retroactive to the years 1935 to 1937 inclusive (Rec. 195, 196); that the words "cancelled or reduced", in Section 270 did not apply to an exchange of bonds for stock in a new company because the assets of the company were not freed from obligation but merely a capital stock liability was substituted for a debt obligation; that the cost of the building was \$385,326.37 instead of \$424,609.19, which had been taken as a basis of depreciation for 15 years (Rec. 184, 198); that there was no evidence in the record whether \$80,022.20 of defaulted interest was taken as a tax benefit by the taxpayer and this question was not at issue in the case either by the pleadings or evidence, but deducted this sum from the cost of the building as a basis for depreciation and arbitrarily changed the rate of depreciation from 1925 to 1935 without any evidence to guide it and without this being an issue in the case (Rec. 197). It also disallowed certain deductions for 1937 for repairs and painting, without any evidence to support its finding.

The Circuit Court of Appeals for the Seventh Circuit, held Section 270 of the Chandler Act was retroactive and applied to the years 1935 to 1938 inclusive; that an exchange of bonds for stock was a cancellation within the meaning of Section 270 and the amount to be deducted from the cost of the building as adjusted was the difference between \$277,000 face of the bonds, and the fair market value of the 2770 shares of stock received in exchange for the bonds; it found the fair market value was \$45.00 per share. This deduction from the cost even of \$424,609.19 as adjusted would bring the value of the building below \$141,000, which was the market value of the building on May 14, 1935, the date the plan was approved. It held \$141,000 should be taken as the basis of depreciation, as of May 14, 1935. It also affirmed the Tax Court of the United States in disallowing deductions of painting and repairs for 1937. It affirmed the Tax Court on the points appealed by the taxpayer in case No. 8296, and reversed the Tax Court in all points of the appeal in case No. 8297. In the Circuit Court of Appeals for the Seventh Circuit, the commissioner in his brief conceded it was a tax free reorganization within the meaning of Section 112 of the Internal Revenue Act of 1934.

The Claridge Building Corporation built a large apartment building in 1924 (Rec. 24, 25, 219). On March 25, 1925, it issued 1st mortgage bonds of \$340,000 (Rec. 75). On Oct. 1, 1931 foreclosure proceedings were started for non-payment of interest (Rec. 76). The principal amount of bonds then due were \$277,000 (Rec. 76). A decree of sale was had (Rec. 76). Then a reorganization was had at the instance of 93 per-cent of the bondholders and all the stockholders (Rec. 75) in 77B proceedings whereby bondholders exchanged 277,000 face value of bonds for 2770

shares of stock of no par value in Claridge Apartments Company (Rec. 76). Stockholders of Claridge Building Corporation obtained 10 per cent or 308 shares of stock in Claridge Apartments Company (Rec. 77). All the property of Claridge Building Corporation was transferred to Claridge Apartments Company (Rec. 77, Par. 1; Rec. 79, Par. 4 and (a), (b), (c), (d); Rec. 80, 40, 81, 182).

Petition for certiorari was allowed by this Court in this case on March 27, 1944 and in the companion case No. 701. In case No. 701 we contend that the Circuit Court of Appeals erroneously found that Section 270 of the Chandler Act applied to this case at all as Claridge Apartments Company received no benefit from Section 268 of the Chandler Act since it was admittedly a tax free reorganization and apart from Section 268 of the Chandler Act, neither the corporation was taxable nor could any of its stockholders take losses from the reorganization; there was no debt forgiveness from the exchange or sale by bondholders of their bonds for Capital stock in the new corporation; that Section 276 (c) of the Chandler Act makes Section 270 applicable only to Corporations where reorganization proceedings were *pending* under Section 77b when the act became effective Sept. 22, 1922. The plan of reorganization in the case at bar was approved May 11, 1935 and the final decree was entered March 1, 1937 (Rec. 187); and the Chandler Act is not retroactive to cover the tax years of 1935, 1936, 1937, and prior to Sept. 22, 1938 because Section 276 (c) of the Chandler Act does not so provide.

We contend in this case that the tax court erroneously deducted from the basis of depreciation \$80,022.20 defaulted interest on the theory it was taken as a tax benefit though admittedly there was no evidence of this and it was not at issue in the case by pleadings or evidence (Rec. 197).

If the court decides in case No. 701 that the Chandler Act does not apply at all to this case as neither it or its stockholders benefitted by Section 268 of the Act or because Section 276 (c) makes Section 270 applicable only to pending cases under Section 77b and not to finished cases, then the question whether the tax court properly deducted said \$80,022.20 from the basis of depreciation becomes moot as it undoubtedly in that case improperly deducted that sum. If this court holds Section 270 does apply to this case, and affirms the tax court in every respect as to its applicability, then all the questions complained about in this appeal of case No. 702 are involved.

Assignment of Errors.

1. The Circuit Court of Appeals for the Seventh Circuit erred in affirming finding of Tax Court of the United States that the cost of the building in this case was \$385,326.37 instead of \$424,609.19 as the uncontradicted and unimpeached documentary and oral evidence showed.

2. The Circuit Court of Appeals for the Seventh Circuit erred in affirming judgment of the Tax Court of the United States deducting \$80,022 defaulted interest from the cost price of the building in this case when there was no issue on this question in the pleadings or evidence and admittedly absolutely no evidence supports such a finding.

3. The Circuit Court of Appeals for the Seventh Circuit erred in affirming decision of the Tax Court of the United States, changing the rate of depreciation of the building in this case over a period of ten years that had been allowed by the commissioner, without the rate of depreciation for that time being an issue in the pleadings.

or evidence and no evidence of any kind supports such a finding.

4. The Circuit Court of Appeals for the Seventh Circuit erred in disallowing deductions for painting and repairs for the tax year of 1937 as the uncontradicted evidence showed these items were proper deductions.

ARGUMENT.

Summary.

I.

It was an error of law for the Tax Court arbitrarily and with no evidence to support it to find the cost price of the building was \$385,326.37 instead of \$424,609.19.

P. C. Tomson & Co., Inc. v. Com., 82 Fed. Rep. (2d) 398 (C. C. A. 3rd Cir. 1937), p. 398.

Foster v. Com., 57 Fed. Rep. (2d) 516 (C. C. A. 5th Cir. 1932), p. 518.

Ox Fibre Brush Co. v. Blair, 32 Fed. Rep. (2d) 42 (C. C. A. 4th Cir. 1929), p. 44.

Nichols v. Com., 44 Fed. Rep. (2d) 157 (C. C. A. 3rd Cir. 1930), p. 159.

II.

When unimpeached documentary evidence and verbal testimony, uncontradicted, credible, and not improbable, are introduced, the Tax Court of the United States cannot disregard it but must accept it as true. The books of original entry and the testimony of Charles F. Henry show the cost of the building at 4501 Malden St., Chicago, to be \$424,609.19. They are unimpeached, the evidence is credible, and not improbable.

Boggs & Buhl, Inc. v. Com., 34 Fed. Rep. (2d) 859 (C. C. A. 3rd Cir. 1929), p. 860, 861.

Pittsburgh Hotel Co. v. Com., 43 Fed. Rep. (2d) 345 (C. C. A. 3rd Cir. 1930), p. 347.

III.

The United States government, though a sovereign, when it litigates with a private citizen is estopped to make assertions just as private individuals are estopped, when equity requires it. For 15 years petitioner and its predecessor, reported the cost of its building to be \$424,609.19 in its income tax returns. For 15 years respondent accepted this valuation when he could have demanded proof. He is now estopped to question this valuation.

State of Illinois v. I. C. R. R. Co., 246 Ill. 188. (1910), p. 248.

State of Indiana v. Milk, 11 Fed. Rep. 389 (C. C. D. Ind. 1882), pp. 396, 397.

U. S. v. Thelka, 266 U. S. 328 (1924), p. 339.

Walker v. U. S., 139 Fed. Rep. 409 (C. C. M. D. Ala. 1905), p. 412.

IV.

A court has jurisdiction to decide only the issues presented by the pleadings. It cannot decide issues not presented by the pleadings. The Tax Court of the United States erred in finding that \$80,022.20 should be deducted from the cost price of the building as adjusted, to find the basis for depreciation for income tax of 1938, on account of alleged use of defaulted interest on the bond issue by Claridge Building Corporation from 1931 to 1935 as provided in Section 270 of the Chandler Act, because that issue was not presented by the pleadings in the case, no evidence was taken thereon by either party, and the decision of the Tax Court of the United States is wholly unsupported by any evidence. All the evidence in the case was to the contrary. Furthermore no issue was

raised by the pleadings or the evidence as to the proper rate of depreciation of the building from 1925 to 1935. The Tax Court of the United States arbitrarily, without any evidence to support it, found that the cost of the building as depreciated on August 1, 1935 was \$239,377.33. The cost using the original figure of \$385,326.37 as found by the court, and the rate of depreciation allowed by the commissioner for fifteen years would be \$246,082.66.

Reynolds v. Stockton, 140 U. S. 254 (1891), pp. 264, 266, 268.

J. P. Jorgensen v. Rapp, 157 Fed. Rep. 732 (C. C. A. 9th Cir. 1907), p. 738.

Munday v. Vail, 34 N. J. Law 418 (1871), p. 422.

V.

Insolvency once proved is presumed to continue until the contrary is shown. On Sept. 15, 1931, foreclosure proceedings were started against Claridge Building Corporation because of inability to pay interest on the first mortgage and taxes. From 1931 to Aug. 1, 1935, no interest was paid on the first mortgage but the whole accrued sum of \$80,022.20 remained unpaid. \$13,000 of general real estate taxes remained unpaid during that period. Only \$8,000 was accumulated by the receiver during that period. Nearly \$13,000 per year of depreciation was allowable on its accounting. During all this time it was operated by Trustee Melvin L. Straus. The original presumption and these proved facts tend to show that it was not necessary to take credit for unpaid interest on income tax returns.

Cleage v. Hardy, 49 Fed. Rep. 346 (C. C. A. 8th Cir. 1906).

Adams v. State, 87 Ind. 573 (1882), p. 575.

Wachsmuth v. Penn. Mutual Life Ins. Co., 147 Ill. App. 510 (1909).

VI.

The law is that if the Commissioner of Internal Revenue makes a finding of fact on substantial evidence, and no evidence is adduced to overcome this, it stands.

Where, however, the Commissioner of Internal Revenue made no finding of fact on the subject, it is error for the Tax Court of the United States to make one for him arbitrarily without any evidence. This it did as to \$80,022.20 deducted from basis of depreciation on account of supposed use of defaulted interest as tax benefit under Section 270 of Chandler Act. There is no presumption of fact in this regard in the absence of evidence. The presumption in favor of Commissioner's finding is rebutted when the Tax Court makes a finding different from his.

City of Indianapolis v. Keeley, 167 Ind. 516 (1906), p. 527.

Andrews v. Commissioner, 135 Fed. Rep. (2d) 314 (C. C. A. 2nd Cir. 2-31-43), p. 318.

VII.

The finding of the Tax Court of the United States that \$1,291.44 of decorating and \$389.60 of repairs were charged in the returns of the taxpayer for both 1936 and 1937 is not supported by any substantial evidence and therefore should be reversed.

ARGUMENT.

I.

Petitioner's Exhibit 2 is a book of original entry, showing the cost of the building at 4501 Malden St., Chicago, Illinois (Rec. 219). Mr. Charles F. Henry, the general contractor for Claridge Building Corporation, kept it in his own handwriting except for minor parts because the various subcontractors were paid as the work progressed. It involved special knowledge of a builder to ascertain from time to time what each subcontractor was entitled to. That knowledge the bookkeeper did not have and Mr. Henry did have (Rec. 32, 33, 25, 26). So he put down in his own handwriting what was paid each subcontractor at the various times, and the cost of materials. This account book has been transferred bodily to this court from the Circuit Court of Appeals as it was too costly to print it. The book showed \$385,326.37 as cost of materials and labor except for general contractor's profit of 10% or \$38,532.64. That appears in pencil in the book. Mr. Henry also testified there were odds and ends that came up at the last minute not put down in the book which made the total cost \$424,609.19 (Rec. 25, 26), which was the cost price put in all made income tax returns from 1925 to 1940, and was originally ascertained by him and his bookkeeper. The cost price was unquestioned by the government until they brought the proceedings in this case in 1940.

The respondent produced no evidence whatever to contradict the testimony of Mr. Henry on the book of original

entry. Yet the Tax Court of the United States, without any evidence to support their finding, found that the original cost of the 106 apartment building and four stores at 4501 Malden St., Chicago, was \$385,326.27 (Rec. 184, 198). They did not disclose whether or not any of the court were builders and knew the testimony of Mr. Henry was wrong. They simply arbitrarily guessed that this figure was wrong and created a finding out of nothing that \$385,326.37 was the correct figure.

It is an error of law for the Tax Court of the United States arbitrarily to make a finding of fact unsupported by any evidence whatsoever.

In the case of *P. C. Tomson & Co., Inc. v. Comm.*, 82 Fed. Rep. (2nd) 398 (C. C. A. 3rd Cir. 1935), p. 398, the question was as to the value of the "Red Seal Lye" brand on March 1, 1931. The commissioner introduced no evidence. The petitioner called five experienced witnesses who testified the value was from 9 to 10 hundred thousand dollars. The board put it in at \$525,000.

The court said (p. 398):

"We have searched the record and find no evidence whatever to support the Board's valuation. Such being the case, the Board's finding must be set aside as unwarranted and the determination of the commissioner approved."

In *Foster v. Comm.*, 57 Fed. Rep. (2d) 516 (C. C. A. 5th Cir. 1932), p. 518, the question was the value of timber on March 1, 1913, and in 1921. Two employees valued the timber at \$5.00 per thousand in 1931, and \$8.00 per thousand in 1921. In an estate the timber was valued in an inventory at \$3.50 per thousand, \$1.50 being deducted for

carrying charges. It had been sold for \$5.00 per thousand when cut in 1920, the term of cutting being indefinite. The commissioner and board valued it at \$3.50 per thousand in 1913 and \$5.00 per thousand in 1921.

The Circuit Court of Appeals valued the timber at \$5.00 per thousand both in 1913 and 1921.

The court said (p. 518):

"We are not bound by a value the basis of which is arbitrarily or theoretically set down. The Board may not create; it must find in the evidence the value which it fixes."

In *OrFibre Brush Co. v. Blair*, 32 Fed. Rep. (2d) 42 (C. C. A. 4th Cir. 1929), p. 44, the president and treasurer owned 36% of the stock of a company, the balance of the stock being owned mostly by employees. They built the business from one losing over \$3,000 per year to one making \$158,753.07 per year.

In recognition of these services, the directors on May 6, 1920, voted each \$24,000 additional salary. The Board of Tax Appeals interpreted this to mean \$24,000 each additional salary for 1920 and disallowed these items on the ground there was no showing of extraordinary services in 1920 over other years. The Circuit Court of Appeals in reversing this decision said (p. 45):

"We find no evidence whatever to support this conclusion."

In *Nichols v. Comm.*, 44 Fed. Rep. (2d) 157 (C. C. A. 3rd Cir. 1930), petitioner sold lands for cash and bonds in 1920. Four prominent men of the neighborhood testified the bonds had no market value and no money could be

borrowed on them at the time of the sale. Nevertheless, the commissioner and Board of Tax Appeals valued them at \$11,000. In setting aside these decisions and affirming return of petitioner, the court said (p. 159):

"Its own findings are not predicated on any substantial evidence and therefore its redetermination is set aside."

II.

When unimpeached documentary evidence and verbal testimony, which is not contradicted, is credible and not improbable, the Tax Court of the United States cannot disregard it but must accept it as true. The book of original entries of the general contractor, Charles F. Henry in his own handwriting made at the time of the building from day to day and known by him to be true, and not impeached in any way, certainly is the best evidence that may be obtained after 15 years acceptance of the figures by the commissioner. Mr. Henry satisfactorily explained all these figures after a lengthy cross examination by respondent. A court cannot create evidence out of its own mind of occurrences 16 years old, as it has attempted to do in this case, after a litigant has waited 15 years before challenging the correctness of this cost. After that time the memory even of the general contractor is dulled and he must rely to a certain extent on the book of original entries.

The Tax Court of the United States says it is not satisfied that Mr. Henry gave anything more than vacant lots to Claridge Building Corporation for the issuance to him of \$100,000 par value of its stock (Rec. 198). The Tax Court of the United States valued the lots at \$16,000 as of August 1, 1935 (Rec. 190). It can scarcely be said that

vacant lots worth \$16,000 August 1, 1935 were worth \$100,000 in March, 1924. Under the rulings of the Tax Court of the United States, Charles F. Henry would have subjected himself to a large stockholder's liability by transferring these lots to Claridge Building Corporation for \$100,000 of its capital stock.

He contends, however, that he took this capital stock not only in payment for the lots but also in payment of his general contractor's commission of 10% of \$38,532.64. In that way he could probably avoid any stockholder's liability which no ordinary business man would want to incur. It is submitted therefore that it is more credible to believe Mr. Henry was paid this commission in this way than to believe the finding of the Tax Court of the United States that he did not obtain this commission at all.

The Tax Court of the United States cannot disregard this uncontradicted testimony and create thus in its own mind evidence of occurrences 16 years old. This is error as a matter of law.

In *Boggs & Buht, Inc. v. Comm.*, 54 Fed. Rep. (2nd) 859 (C. C. A. 3rd Cir. 1929), pp. 860, 861, the question was the value of the good will of a store. All the direct and expert testimony, by men of wide business experience in Pittsburgh where the store was located, was that the good will was worth a million dollars. There was no evidence to the contrary. Yet the Board found it worth \$600,000. The Circuit Court of Appeals found it was worth \$1,000,000, but under the law it could find only for \$975,000.

The court said (p. 860):

"A jury, commission or board may not arbitrarily ignore or discredit the testimony of unimpeached witnesses, so far as they testify to facts, and a wilful

disregard for such testimony will be ground for a new trial."

The court held that in matters of opinion the trial court could disregard the testimony of experts if it had some independent knowledge itself on the subject; that no such knowledge appeared in this case so the decision was reversed. Charles F. Henry testified as to a fact and not an opinion and his evidence, credible and unimpeached as it is, and corroborated, is binding on the court.

In *Pittsburgh Hotel Co. v. Comm.*, 43 Fed. Rep. 345 (C. C. A. 3rd Cir., 1930), p. 347, the dispute was as to the rate of depreciation of the Wm. Penn Hotel in Pittsburgh. Petitioner claimed 4% and the court and commissioner allowed 2%.

The commissioner had no evidence except two clerks in his office who had never seen the hotel and testified 2% was the usual allowance of the commissioner for a building of this character.

Petitioner put on six expert witnesses of Pittsburgh who were well acquainted with the hotel and Pittsburgh. They testified the hotel was "no longer up to date"; that hotels are occupied 24 hours per day and depreciate faster than office buildings which are occupied only part of the time, and that the smoke and grime of Pittsburgh make buildings depreciate faster both on the inside and outside than buildings in other cities.

The Circuit Court of Appeals ordered their determination set aside and the return of the petitioner approved on the ground it did not appear the trial court had any independent knowledge on the subject.

The court said (p. 347):

"It could not, therefore, arbitrarily disregard all the affirmative and positive testimony applicable to depreciation in this particular case."

III.

The United States Government, though a sovereign, when it litigates with a private citizen, is bound by all the equities that arise between litigating citizens including the equitable doctrine of estoppel.

The Commission of Internal Revenue if it wanted to question the cost price of the Claridge Apartments as shown in the income tax return of Claridge Building Corporation of 1925 as \$424,609.19, should have done so when that return was made to it in 1925. Then everything was fresh in the taxpayer's mind and it could readily have proved beyond the peradventure of a doubt the exact cost. Instead, it waited 15 years to raise the point, accepting the figure every year from 1925 to 1940, before questioning it (Rec. 26, 27). The very fact that Mr. Henry, the general contractor, testified 16 years after he built the building for Claridge Building Corporation, instead of the next year after he built it would tend to make his testimony less worthy of belief as courts know the effect of 16 years on one's memory. A private suitor would be estopped at this late date to question this cost figure. So also is the government under the law.

In *State of Illinois v. I. C. R. R. Co.*, 246 Ill. 188 (1910), p. 248, the defendant was required by contract to pay as a tax to the State of Illinois 7% of its gross earnings and report twice per year its earnings to the State. It made these reports from October 31, 1877 to 1905. During that

period its accounts were never questioned. They were subject to examination by the governor for the time being. The State of Illinois in 1905 filed a bill claiming proper accounting had not been made over this span of years. The court held the State was estopped to say that a proper accounting had not been had.

The court quoted from Chief Justice Marshall in the case of *Choppendelaine v. Deschiraux*, 4 Cranch. 305:

"No practice could be more dangerous than that of opening accounts which the parties themselves have adjusted, on suggestions supported by doubtful or by only probable testimony."

In our case there was absolutely no testimony.

The court also said:

"Lapse of time necessarily obscures the truth and destroys the evidence of past transactions."

In *State of Indiana v. Milk*, 11 Fed. Rep. 389 (C. C. D. Ind. 1882), pp. 396, 397, the State of Indiana was granted land including a lake by the Government. The State sold some of the land to individuals. Then it purchased odd numbered lots from individuals and taxed them on the even numbered lots. Then it sought to get back land covered by the lake on the ground individuals had riparian rights only to the water's edge. The court held the statement of law was correct but the State was estopped so to assert by its taxing the even numbered lots and buying the odd numbered.

The court said (p. 397):

"Resolute good faith should characterize the conduct of States in their dealings with individuals, and

there is no reason, in morals or law, that will exempt them from the doctrine of estoppel."

In *U. S. v. Thelka*, 266 U. S. 328 (1924), p. 339, in a libel case, where the government intervened, and the court held it was subject to the justice of the matter the same as if it had been an individual.

See also *Walker v. U. S.*, 139 Fed. Rep. 409 (C. C. M. D. Ala. 1905), p. 412.

IV.

A court can only decide the issues presented by the pleadings. Any decision outside the pleadings is void. \$80,022.20 was deducted from the cost price of the building for the income tax year of 1938 by the Tax Court of the United States (Rec. 206, last line), when the issue on which it was deducted was not raised by the pleadings in the case and no evidence was introduced on the point by either side (Rec. 9, 12, 15, 16, 18, 3, par. 4 (a), (b), (c); Rec. 21, par. 4 (a to h); Rec. 197).

The pleadings in this case consisted of a petition for a redetermination of deficiency income and excess profits taxes for the years 1935 to 1938 inclusive, and an answer thereto. The petition alleges (par. 4 (c), Rec. 3), as follows:

"(c) The Internal Revenue Department of the United States erred in not holding that Petitioner took title in a tax free reorganization under the Internal Revenue laws of the United States and was entitled to take as a basis for depreciation the cost of the property to its predecessor in title."

As a part of the petition was Exhibit "A" which was notice of deficiency assessment of Jan. 17, 1941. As to

each year from 1935 to 1938 inclusive, the ground of the deficiency assessments except as to some painting and decorating and repairs, was asserted to be:

"It has been determined that your basis for depreciation on the apartment building was the fair market value of the property on the date you acquired it, August 1, 1935 or \$182,500."

The answer of respondents to this portion of the petition, is as follows (Rec. 21):

"4 (a) to (h) inclusive. Denies each and every allegation of error contained in subparagraphs (a) to (h) inclusive of paragraph 4 of the petition."

The issue then is clear whether or not, on August 1, 1935, there was a tax free reorganization or the market value of the building on August 1, 1935, was to be taken as the basis for depreciation in income tax returns.

If there were any scaling down under Section 270 of the Chandler Act, it was accomplished by order confirming the plan entered May 14, 1935 (Rec. 84). The market value of the building on that date or whether unpaid interest had been used as tax benefits, were not put at issue by the pleadings or the evidence in this case. It is entirely inadmissible for the Tax Court of the United States to deduct \$80,022.20 from the cost price of the building as of Jan. 1, 1938 to obtain a basis for depreciation for income tax purposes for that year (Rec. 206, last line). That question was not raised by the pleadings or the evidence as the opinion of the Tax Court of the United States admits (Rec. 197). All the evidence in the record points to the fact that such defaulted interest was not used as a tax benefit. The commissioner never made a finding that it was so used.

There is no presumption in his favor. The Tax Court of the United States was absolutely without any evidence whatsoever on which to base this finding. Such a finding cannot stand as shown by the authorities shown in Point I of this argument.

In *Reynolds v. Stockton*, 140 U. S. 254 (1891), pp. 264-266, 268, a New Jersey Insurance Corporation took over a New York Insurance Corporation. On insolvency of the New Jersey corporation, a stockholder and policy holders brought suit in New York to have assets of the insurance corporation deposited in New York applied in satisfaction of obligations to the policy holders of the New York insurance corporation. Without amending pleadings, the plaintiff in this suit obtained a judgment for \$1,000,000 against the New Jersey insurance corporation and its receiver.

The Court of Chancery of New Jersey ignored this judgment and the Supreme Court of New Jersey and of the United States, affirmed this action. It was held the judgment for \$1,000,000 was void because no issue was made by the pleadings in the New York suit, whereby it could be rendered and there was no denial by New Jersey of the effect of the New York judgment in violation of the federal constitution, Article 4, Section 1.

The court said (p. 268):

"A judgment upon a matter outside of the issue must, of necessity, be altogether arbitrary and unjust, as it concludes a point upon which the parties have not been heard."

In *J. P. Jorgenson v. Rapp*, 151 Fed. Rep. 732 (C. C. A. 9th Cir. 1907), p. 738, there was a suit for replevin of logs

Defendant pleaded denying title and right to possession in plaintiff, and sought to set up a *quantum meruit* for services in reclaiming logs in the sea. This set-off was twice stricken. The lower court found issues for plaintiff, but did not enter judgment thereon, but entered judgment in favor of defendants for services in reclaiming logs in amount of \$477.00. The plaintiff brought suit to enjoin enforcement of judgment as no appeal lay for a judgment under \$500.00 then. The lower court denied preliminary injunction, but the Circuit Court of Appeals ruled it should have been entered as the judgment was void as beyond the issues of the case. The court had no jurisdiction to enter it.

In *Munday v. Vail*, 34 N. J. Law 418 (1871), p. 422, there was ejectment suit brought. The defendant claimed he obtained judgment against the owner who promised to secure it with the land, but instead conveyed the land to a trustee for himself and wife, their survivor, and children. The lower court set aside the deed of trust and vested title in defendant. It was held the decree was void insofar as it set aside title to infant defendant given by this trust as such relief was not prayed in the bill, and the question was not at issue.

V.

An insolvent condition whereby interest on first mortgage and taxes are not earned once proven is presumed to continue (Rec. 76). The Court takes judicial notice of the depression years of 1931 to August 1, 1935. It appears in the record that on October 1, 1931, foreclosure suit of the first mortgage on the realty at 4501 Malden St., Chicago, Illinois, was filed for non-payment of taxes and interest on first mortgage (Rec. 76).

If the Claridge Building Corporation then could not pay its taxes and interest, there was no need of resorting to interest to prevent the paying of income taxes for 1931. Besides during all these years it had nearly \$13,000 deductible each year from the income of the property, being 3% of the cost of the building allowable for depreciation (Rec. 26, 27). Then Melvin L. Straus, as Trustee of the property, was put in charge of the property by the State court for the benefit of bondholders. He continued in such possession while the matter was in the federal court under Section 77B of the Federal Bankruptcy Act, being in possession from October 1, 1931 to August 1, 1935. During that period no interest on the first mortgage was paid, and taxes up to \$13,000 remained unpaid. During all this time, nearly \$13,000 was deducted yearly from the income for depreciation on the property (Rec. 93, 95). Yet the Tax Court of the United States on some kind of presumption, it does not describe, and admittedly without a syllable of evidence to support its findings, held that the Claridge Building Corporation took the benefit of this unpaid interest as an income tax benefit for all these years. I submit that the evidence shows it was exceedingly unlikely that such benefit was taken and that the Tax Court of the United States erred as a matter of law, at all events, in this finding, without a syllable of evidence and without any presumption to support its finding. It is submitted the evidence, if it became material under the pleadings, would have shown no such benefit was taken.

In *Cluge v. Lardley*, 149 Fed. Rep. 346 (C. C. A. 8th Cir. 1906), the question was whether a preference was given while debtor was insolvent. It was proved he owed \$25,000 in July, and had assets of only \$50.00. In December following the alleged preference was made. It was held there

was a presumption that he was insolvent in December from proof of his insolvency in July.

In *Adams v. State*, 87 Ind. 573 (1882), p. 575, the question was whether a conveyance of real estate was fraudulent and void. It was proved debtor had no property except that conveyed to his wife in November 1876. It was held jury might infer from this fact he had no other property in December 1877, when the action was instituted.

The court said (p. 575):

"It is a fundamental doctrine that when a fact is once shown to exist, the presumption is that it continues to exist and this presumption stands good till the contrary is shown or a countervailing presumption is raised."

In *Wachsmuth v. Penn. Mutual Life Ins. Co.*, 147 Ill. App. 510 (1909), the validity of a sale of real estate to pay debts in a deceased estate depended on whether the executors were insolvent at the time it was made. They owed the estate \$10,000. It was held that if it was proved they were insolvent at the time of the death of the deceased, it would be presumed they were insolvent at the time of this sale.

VI.

There is no presumption of fact in favor of the commissioner, unless he has made a finding of the fact in assessing the tax. The commissioner, in his notice of deficiency tax of date January 17, 1947 (Rec. 7), bases each explanation of adjustments for the income tax returns of 1935 to 1938 inclusive on the ground that

"Your basis for depreciation on the apartment building was the fair market value of the property on the

date you acquired it, Aug. 1, 1935, or \$132,500" (Rec. 9, 12, 15, 16, 18).

There was no claim of the fair market value on May 14, 1935, the date the plan of reorganization was confirmed, nor any finding that tax benefit had been claimed for unpaid interest from 1931 to August 1, 1935.

There is no presumption of fact or of law that such interest was so used as a tax benefit and if the commissioner claims it was so used he must prove it. Taxpayers are entitled to know the basis of determination of tax deficiencies and to rest assured that no basis not given by the commissioner in making his decision will be later claimed by him unless he at least gave notice thereof. A good case showing under what circumstances presumptions of law and fact arise is the following:

In *City of Indianapolis v. Keeley*, 167 Ind. 516 (1906), p. 527, the lower court instructed the jury in a personal injury case from defective sidewalk that there was a presumption the plaintiff exercised due care in walking on the sidewalk. This was held error on the ground a presumption of law arises from such inferences as are warranted from legal experiences of courts in rendering justice and presumptions of fact are inferences which enlightened common sense may draw from facts and circumstances.

In the case of *Andrews v. Commissioner of Internal Revenue*, 135 Fed. Rep. (2d) 314 (C. C. A. 3rd Cir. 3-31-43), p. 318, a reorganization provided interest on bonds may be paid in scrip of the corporation. The question was the value of this scrip as income in the hands of bondholders. The commissioner valued it at \$50.00 in October 1935, \$52.00

for November, 1935, and \$41.00 for December 1936. The Tax Court of United States valued it at \$35.00. The court held the presumption in favor of the valuation of the commissioner is rebutted when there is no substantial evidence for his price figure, and there was no reasonable basis for the finding of the Tax Court. The evidence on the point was so speculative and uncertain as to form no basis even for a guess.

VII.

The finding of the Tax Court of the United States that in the income tax return for 1937, \$1,291.44 for painting and decorating and \$389.60 for repairs, was deducted from gross income, though these same items had been deducted in the income tax return of 1936, is without any proof in the record to substantiate it and under the decisions cited in Point I of this argument cannot stand.

The only witnesses who testified on the subject are Charles F. Henry and Milton C. Kuehn.

After November, 1937, Mr. Henry was president of Claridge Apartments Company. He testified he examined the daily records of decorators, the actual bills, and that the figures claimed in the 1937 return of decorating and repairs are correct (Rec. 31, 32).

Mr. Kuehn testified he made out the 1936 income tax return, but had nothing to do with the 1937 income tax return. He testified that in 1936 all the items of painting and decorating and repairs incurred in 1936 were deducted; that the company then in its bookkeeping had a system of deferring the painting and decorating on its books, charging it against each apartment. *He nowhere testifies that*

It is further submitted the lower court committed error as matter of law in deducting from the basis of depreciation for the year 1938, \$80,022.20, as unpaid interest on the first mortgage allegedly used as an income tax benefit for the years 1931 to August 1, 1935, when there is no evidence that such was the case and no issue was made on this subject either by the pleadings or the evidence.

Respectfully submitted,

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Attorneys for Petitioner.

APPENDIX.

Section 112 (g) 1 (B) of Income Tax Law of the United States for year 1934. 26 U. S. C. A. p. 695 (a) Definition of Reorganization as used in this Section and Section 113.

(1) "The term "reorganization" means . . . (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock . . . of substantially all the properties of another corporation."

"Section 112 (g) (1) (D) (2). The term "a party to a reorganization" includes . . . both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

Section 112. Reorganization of Gain or Loss. . . .

(b) Exchanges Solely in Kind. . . .

(3) Stock for Stock on Reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) Same.—Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanged property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) Transfer to Corporation Controlled by Transferror.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in

exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; • • • •

Section 113 (a) (6) Revenue Act of 1934, 26 U. S. C. A. p. 697.

(6) Tax free exchanges generally. If the property was acquired after February 28, 1913, upon an exchange described in 112b to e inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the Taxpayer and increased in the amount of gain or decreased in the amount or loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted in Section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it."

SEP 23
CHARTERED BY THE STATE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 28

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONER.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

No. 28

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONER.

MAY IT PLEASE THE COURT:

OPINIONS BELOW.

The opinion of the Tax Court of the United States (R. 183-199) is reported in 1 T. C. 163. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 228-237) is reported in 138 F. (2d) 963.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on December 1, 1943, and petition for rehearing was denied on December 22, 1943 (R. 238). Petition for certiorari was filed February 15, 1944, and granted March 27, 1944. The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. Section 347(a)).

QUESTIONS PRESENTED.

(1) Should the Circuit Court of Appeals affirm a decision of the Tax Court "when there is found to be rational basis for the conclusions approved by the administrative body"?

(2) Is indebtedness "canceled or reduced" within the meaning of the Chandler Act by the difference between the amount of the debt and the fair market value of the stock which creditors received in exchange for the debt?

(3) The statute involved in the case at bar was enacted June 22, 1938, and became effective September 22, 1938. The reorganization plan was confirmed by the District Court May 14, 1935 (R. 187), and final decree was entered March 1, 1937 (R. 187). Thus, this proceeding was not pending when the statute involved in the case at bar became law, having terminated over a year and six months prior thereto. The question which arises on this state of facts is whether section 270 of the Chandler Act applies to proceedings not pending at the time of its enactment?

(4) Assuming that Section 270 of the Chandler Act applies to proceedings not pending at the time of its enactment but terminated long prior thereto, is it retroactive so

as to apply to the computation of income taxes for years prior to its enactment, as the court below held, or does it only apply to such plans for purpose of tax computation starting with the year of its enactment as the Tax Court held in the case at bar and as the Circuit Court of Appeals for the Sixth Circuit has held?

STATUTE AND REGULATIONS INVOLVED.

The statute and regulations involved are set forth in the appendix. The statute does not define the word "canceled." The regulation merely repeats the statute and does not purport to clarify it.

STATEMENT.

The facts, as found by the Tax Court, so far as material to the questions involved in this case (No. 28), are as follows:

The taxpayer is a corporation organized on May 28, 1935, under the laws of the State of Illinois, pursuant to a proceeding under Section 77-B of the Bankruptcy Act. It filed its income and excess profits tax returns for the years 1935 to 1938, inclusive, with the Collector of Internal Revenue for the First District of Illinois (R. 184).

In determining deficiencies for each of these years the Commissioner reduced the depreciation allowance claimed by the taxpayer on its returns (R. 9, 12, 15-16, 18-19) because he claimed the basis for depreciation was the fair market value of the property "on the date you acquired it, August 1, 1935, or \$132,500" (R. 9), instead of the basis to taxpayer's predecessor.

The Commissioner did not apply section 270 to this case. If he had he would have valued the property as of the date of the order confirming the plan (May 14, 1935) as section 270 provides (R. 84). Instead, he issued the notice of deficiency solely on the theory that no tax free reorganization took place. He stated in said notice:

"It has been determined that your basis for depreciation on the apartment building was the fair market value of the property on the date you acquired it, August 1, 1935, or \$132,500." (R. 16.)

The Tax Court found:

In 1924 the Claridge Building Corporation (herein called the Building Corporation) acquired a certain lot in Chicago from Charles F. Henry, pursuant to a contract whereby the Building Corporation agreed to issue and did issue its entire authorized capital stock to Charles F. Henry in consideration therefor. During the spring and summer of 1924, the Building Corporation caused an apartment building to be erected on the lot at a cost of \$385,326.37. By August 1, 1935, depreciation amounting to \$139,253.71 had been taken on a "cost" of \$424,609.19, which included a contractor's commission to Charles F. Henry (R. 184).

On March 25, 1924, the Building Corporation issued its 6½ per cent first mortgage bonds in the principal amount of ~~\$340,000~~. By October 1, 1931, the bonds were outstanding and unpaid in the principal sum of \$277,000. Defaults having occurred both in principal and interest, the trustee filed a bill for foreclosure on October 1, 1931, and all of the bonds were declared immediately due and payable. A decree of foreclosure was entered on February 19, 1933, but there was no sale of the mortgaged property under

the decree and the foreclosure proceeding was never consummated. The trustee took possession of the property and collected the rents after October 1, 1931 (R. 184).

On June 7, 1934, section 77-B was added to the Bankruptcy Act and on June 16, 1934, the Building Corporation filed a voluntary petition in the District Court of the United States for the Northern District of Illinois, Eastern Division, under Section 77-B of the Bankruptcy Act, as amended (R. 185).

On November 27, 1934, the bondholders' committee, the Building Corporation, and one Minnie H. Case agreed on a reorganization plan. The plan provided for the formation of a new corporation to acquire the property. The new corporation would have an authorized capital stock of 3,080 shares. Ninety per cent of the outstanding stock, or 2,770 shares, would be held by trustees, and the trust certificates would be issued to the bondholders on the basis of one share of stock for each \$100 face amount of bonds. Ten per cent of the stock would go to the old stockholders (R. 185). This plan was confirmed and approved by the court by an order dated May 14, 1935. The order stated that the bonds and interest coupons were satisfied and of no further force and effect and authorized the issuance of the new securities for them (R. 187):

The taxpayer was organized pursuant to the plan and the property transferred to it (R. 188). Under the plan the taxpayer's stock was issued at the rate of one share per \$100 face value of the bonds of the old company. The fair market value of the stock never exceeded \$45 per share at any time during the year 1935. Of taxpayer's 3,080 shares of common no par value stock, 2,770 shares were issued to non-depositing bondholders and to trustees

for the depositing bondholders, 308 shares to old stockholders and 2 shares remained unissued (R-189).

DECISION OF THE TAX COURT.

The final decree in the Section 77-B proceeding entered March 1, 1937, declared the first mortgage bonds in the principal amount of \$277,000 and interest coupons attached and the trust deed and chattel mortgage, which secured them, to be of no further force and effect as against the debtor and its property, and that the holders thereof should, in lieu thereof, be entitled to receive only the new securities provided for in the plan of reorganization (R-187).

The Tax Court held that the bonds were not "canceled or reduced" within the meaning of the statute because they were exchanged for stock and the bondholders took the property of the debtor in exchange for their bonds.

The Tax Court also followed its decision in *The Commodore*, 46 B. T. A. 712 (since affirmed by the Circuit Court of Appeals for the Sixth Circuit in 135 F. (2d) 89), and held that no tax year earlier than 1938 (the year the Statute was enacted) would be effected by section 270 of the Chandler Act, which became effective September 22, 1938.

Upon appeal, the learned court below did not consider whether the decision of the Tax Court rested upon a rational basis. It brushed aside the holding of the Tax Court and the holding of the Circuit Court of Appeals for the Sixth Circuit on the non-retroactivity of the statute with the statement "the legislative intent here is not left in doubt."

It also overruled the holding of the Tax Court that the debt was not "canceled" because it was exchanged for stock and because the property was taken in satisfaction of it with that statement that "stock was not a debt" (R. 232). No one ever contended it was. That it is not a debt is a false and immaterial issue.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

(1) In failing to hold the decision of the Tax Court rested upon a rational basis and therefore should be affirmed;

(2) In holding that debt had been "canceled" by the exchanging of stock for it in the 77-B proceeding;

(3) In holding that the statute was retroactive so as to compel the reopening of cases and the recomputation of income tax liability for years prior to its enactment; and

(4) In failing to hold that the section of the Chandler Act involved in the case at bar did not apply to proceedings which were not pending at the time of its enactment, and in which a final decree had been entered prior thereto.

SUMMARY OF ARGUMENT.

(1) It is first submitted the decision of the Tax Court was a reasonable, rational and plausible construction of Section 270 and, therefore, should not have been reversed.

(2) It is next submitted that, considering the question *de novo* and wholly unfettered by any deference to the Tax

Court's decision, it must be concluded Congress intended by Section 270 what the Tax Court said it did.

(3) Section 270 is not retroactive beyond the date of its enactment is the next point made.

Finally, as point (4), it is submitted Section 270 does not apply to proceedings under 77-B in which a final decree was entered prior to the enactment of the Chandler Act but only to proceedings then pending under Section 77-B and those commenced thereafter under the Chandler Act. It is necessary, in any event, to decide this point because of the Tax Court's holding that the basis must be reduced for 1938 and subsequent years by the amount of the canceled interest. This question (4) was overlooked by the Tax Court.

When the Court below decided the case at bar, it did not have the benefit of this court's decision in *Dobson v. Commissioner*, 320 U. S. 489, wherein this court observed at p. 501, "the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body"; that the decision of the Tax Court must stand unless the Appellate Court can identify a "clear-cut mistake of law" (at p. 502). In this case, as in that, "the statute gives no inkling of the correctness or incorrectness of the Tax Court's view" and there is no regulation purporting to explain in what circumstances debt is "canceled."

Conceding the court below was empowered by the statute (I. R. C. sec. 1141(c)(1)) to reverse the decision of the Tax Court, if it was "not in accordance with law," it is submitted that before it could do so it was incumbent on the appellant to show that the Tax Court's decision

was plainly, obviously, patently and palpably contrary to law and not merely raise doubts about it. Also, the Appellate Court should not, as it did in the case at bar, approach the legal question as if it were sitting *de novo* in a trial court but should indulge every presumption in favor of the Tax Court's decision and make the appellant discharge the burden of demonstrating clearly and beyond reasonable doubt that the decision below was not in accord with statute and, if the Tax Court's decision is a reasonable and rational application of the statute, it should be affirmed albeit the Appellate Court can think of a more reasonable one. The Appellate Court should "conform to it when possible." (*Dobson* case, 320 U. S. 501, 502.) Only thus can a flood of tax litigation of such avalanche proportions as to overwhelm courts be avoided and prompt collection of the revenue, reasonable certainty in tax questions essential to business transactions and due regard for administrative agencies be obtained. Only thus can we avoid a hodge-podge, sick-making mess being brewed by a variety of inexperienced, uninformed, unqualified cooks. In the *Dobson* case this court held the decisions of the Tax Court were entitled to "at least" equal respect to those of other administrative agencies and, as pointed out in *Gray v. Powell*, 314 U. S. 402, patently to attach special weight only to findings of fact and not to conclusions of law is to reduce the administrative agency to a mere fact finding commission. (Cf. *National Labor Relations Board v. Hearst Publications*, 322 U. S. 111, at p. 131) or agency to certify facts to the Circuit Courts for determination of their legal effect.

There is no difference between the principle for which we contend and the old, well established principle that a regulation interpreting a law, has the force of law if it is a rational interpretation. Indeed, our contention is sup-

ported by stronger reason, because, as observed in the *Dobson* case, the Tax Court is impartial, whereas the Revenue Bureau acts not impartially and judiciously but contentiously in the knowledge that, if it rules a doubtful matter in favor of taxpayers; its right to litigate the question is thereby foreclosed. Also, a regulation is made *ex parte* but a Tax Court's decision only after hearing. In other words, when an administrative agency, acting within scope of its statutory authority to promulgate regulations, considers a statute and makes a regulation which is a rational and plausible interpretation of the statute, such regulation has the force of law even though a court charged with the same duty might have promulgated a different regulation or even though a reviewing court can think of a more reasonable one.¹ *A fortiori* when the Tax Court, acting as an administrative agency, promulgates a decision interpreting a section of the taxing statute and such

¹ On page 21 of his brief in the court below, respondent states as follows:

"Moreover, it is also a well recognized canon of construction that an administrative interpretation is entitled to great weight and should not be disturbed unless plainly wrong. *Fawcett Machine Co. v. United States*, 282 U. S. 375; *Maryland Casualty Co. v. United States*, 251 U. S. 342, 349; *Spring City Co. v. Commissioner*, 292 U. S. 182, 189; *Helvering v. Wilshire Oil Co.*, 308 U. S. 90; *Helvering v. Reynolds*, 313 U. S. 428, 433-434; *Textile Mills Corp. v. Commissioner*, 314 U. S. 326, 337-339; *White v. Winchester Club*, 315 U. S. 32, 41; *United States v. Joliet & Chicago R. Co.*, 315 U. S. 44, 47-48."

If such weight is given an *ex parte* regulation, which does not state any reasons for its conclusion, much more weight should be given the considered determination of the Tax Court experts (who are more expert than the Bureau experts) because they are impartial, decide only after hearing and state the reasons for their conclusions.

decision is rational and not plainly contrary to the words of the statute or to any regulations of the Treasury Department interpreting the statute, it follows by analogy that such decision has the force of law and cannot be overturned by the courts. Before it can be overturned, it must be obviously contrary to the plain words or clear purpose of the statute. In such case it is not a rational interpretation. The Appellate Court "should not be permitted to search for the correct interpretation of a statute, after an administrative agency has made such a determination, but should merely inquire as to the reasonableness of the particular determination which has been made." 47 Yale Law Journal 597; 9 George Washington Law Review 514.

On the second phase of the argument and wholly apart from the above, the Tax Court should be affirmed and the court below reversed because the debt was not "canceled" when exchanged for stock. This conclusion follows whether the Statute be considered alone and the word "canceled" given the meaning in which it would ordinarily be understood in its statutory setting or whether its meaning be considered doubtful and resort be had to legislative history for enlightenment. The committee reports state, as plainly as language can, the statute in question was designed "to prevent a double deduction" and to embrace cases of "debt forgiveness." No debt forgiveness is present here and no double deduction. Instead of forgiving the debt, its owners exacted their pound of flesh for it, exchanged one evidence of ownership for another, and the conclusion of the Tax Court that a non-taxable reorganization took place is not challenged by respondent here. Also, the construction contended for by respondent would discriminate against corporations undergoing in federal bankruptcy a non-taxable reorganization in fa-

vor of corporations doing the identical thing in state court proceedings and in favor of solvent corporations exchanging bonds for stock. It would impose the burden of section 270 on a corporation which had no benefit from section 268. This runs counter to the rule requiring liberal construction of bankruptcy acts to help the bankrupt, the further rule that remedial legislation is to be construed liberally, to the still further rule that doubts are to be resolved in a taxpayer's favor and to the constitutional requirement that excises must operate uniformly.

On the third point, the Tax Court and the Circuit Court of Appeals for the Sixth Circuit are patently right in holding section 270 inapplicable in the computation of income taxes for taxable years prior to its enactment (1938) and the court below is wrong in holding it retroactive to and including 1934 and in requiring reopening and recomputation of income taxes for the years 1934, 1935, 1936 and 1937, for which income tax returns had been filed before section 270 became law on September 22, 1938. If Congress had intended to carry the statute back five years, it would have plainly said so. Instead, the committee report said future tax liability only was effected. Also, if such a construction does not render the statute unconstitutional, it at least raises a constitutional doubt and a construction which does this is to be avoided. *United States v. Moy*, 241 U. S. 394, 401.

Finally, it is submitted the Chandler Act does not apply to proceedings in which final decrees had been entered before it was enacted. They were not pending at the time and their reorganization plans could not be revised in the light of the Act.

ARGUMENT.**I.****The Tax Court's Construction of the Statute Was a Rational, Reasonable and Plausible One and Should Have Been Affirmed on this Ground Alone.**

In *Dobson v. Commissioner*, 320 U. S. 489, this court recognized that the statute grants authority to Circuit Courts of Appeal to reverse the decisions of the Tax Court when "not in accordance with law." However, this court stated (p. 501): "The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body."

This court also said of the Tax Court, at pages 498 and 499:

"The court is independent, and its neutrality is not clouded by prosecuting duties. Its procedures assure fair hearings. Its deliberations are evidenced by careful opinions. All guides to judgment available to judges are habitually consulted and respected. It has established a tradition of freedom from bias and pressures. It deals with a subject that is highly specialized and so complex as to be the despair of judges. It is relatively better staffed for its task than is the judiciary. Its members not infrequently bring to their task long legislative or administrative experience in their subject. The volume of tax matters flowing through the Tax Court keeps its members abreast of changing statutes, regulations, and Bureau practices, informed as to the background of controversies and aware of the impact of their decisions on both Treasury and taxpayer. Individual cases are dis-

posed of wholly on records publicly made, in adversary proceedings, and the court has no responsibility for previous handling. Tested by every theoretical and practical reason for administrative finality, no administrative decisions are entitled to higher credit in the courts. Considerations of uniform and expeditious tax administration require that they be given all credit to which they are entitled under the law."

✓ This court also said, "Every reason ever advanced in support of administrative finality applies to the Tax Court."

Inasmuch as the decisions of the Tax Court are entitled to at least equal credit with those of other administrative bodies, it is important to consider the effect of such other decisions on appeal and the scope of judicial review thereof. As to the Interstate Commerce Commission, this court in *Rochester Telephone Corp. v. United States*, 307 U. S. 125, at page 140, said, "Only questions affecting constitutional power, statutory authority and the basic prerequisites of power can be raised. If these legal tests are satisfied, the commission's order becomes incontestable."

In that case this court also declared, at page 146, the rule for review of decisions of the Federal Communications Commission. This court said: "So long as there is warrant in the record for the judgment of the expert body, it must stand." It then said: "The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body."

In *Gray v. Powell*, 314 U. S. 402, involving a decision of the Director of the Bituminous Coal Commission, it was

contended the courts on review might consider questions of law *de novo* but this court, at page 412, stated that under such a view "executive or legislative agencies become mere fact-finding bodies deprived of the advantages of prompt and definite action." The court also said: "Certainly a finding on Congressional reference that an admittedly constitutional act is applicable to a particular situation does not require such further scrutiny. Although we have here no dispute as to the evidentiary facts, that does not permit a court to substitute its judgment for that of the Director."

In *National Labor Relations Board v. Hearst Publications, Inc.*, 322 U. S. 111, this court adopted the views advanced by the Department of Justice in its brief in that case and said, at pages 130 and 131:

"Undoubtedly questions of statutory interpretation, especially when arising in the first instance in judicial proceedings, are for the courts to resolve, giving appropriate weight to the judgment of those whose special duty is to administer the questioned statute. *Norwegian Nitrogen Products Co. v. United States*, 288 F. S. 294, 77 L. ed. 796, 53 S. Ct. 350; *United States v. American Trucking Assos.*, 310 U. S. 534, 84 L. ed. 1345, 60 S. Ct. 1059. But where the question is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially, the reviewing court's function is limited. Like the commissioner's determination under the Longshoremen's & Harbor Workers' Act, that a man is not a 'member of a crew' (*South Chicago Coal & Dock Co. v. Bassett*, 309 U. S. 251, 84 L. ed. 732, 60 S. Ct. 544) or that he was injured 'in the course of employment' (*Parker v. Motor Boat Sales*, 314 U. S. 244, 86 L. ed. 184, 62 S. Ct. 221) and the Federal Communications Commission's determination that one company is under the

'control' of another (*Rochester Teleph. Corp. v. United States*, 307 U. S. 125, 83 L. ed. 1147, 59 S. Ct. 754), the Board's determination that specific persons are 'employees' under this Act is to be accepted if it has 'warrant in the record' and a reasonable basis in law."

It is submitted the Tax Court's decision must be accepted on appeal "if it has warrant in the record and a reasonable basis in law" especially where the question at bar "is one of specific application and a broad statutory term" to a specific state of facts.

There being no controlling regulation and the construction of the Tax Court being a rational and plausible construction and no "strained or artificial construction of the statute" it must stand. Cf. *Helvering v. Reynolds*, 313 F. (2d) 428, 433; *Maryland Casualty Co. v. United States*, 251 U. S. 342, 349, dealing with departmental regulations. See also *Billings v. Truesdell*, 321 U. S. 542, 552, 553.

In *Williamsport Wire Rope Company v. United States*, 277 U. S. 550, this court held that the courts had no jurisdiction to consider questions of law arising under sections 327 and 328 of the Revenue Acts of 1918 and 1921. In *Blair v. Oesterlein Machine Co.*, 275 U. S. 220, it held the Tax Court had such jurisdiction. In *Duquesne Steel Foundry Co. v. Burnet*, 283 U. S. 799, and *Heiner v. Diamond Alkali Co.*, 288 U. S. 502, it held the circuit courts of appeal had no jurisdiction to consider questions of law arising out of the decision of the Tax Court in such cases. This decision could not have been put upon any express words of the statute conferring jurisdiction and must have been rested on the peculiar expert capacity of the Tax

Court. The contrary conclusion had been reached in *Ryan Car Co. v. Commissioner*, 44 F. (2d) 26, which points out that there are no statutory words supporting the decision finally made by this court.

The judicial code appears to give the circuit courts of appeal the same jurisdiction and authority to review cases arising in the courts of insular possessions as they have to review cases arising in our own district courts but, in *Decastro v. Board of Commissioners*, 322 U. S., this court emphasized that where the question is one of local law in which the local courts are especially competent, "to justify reversal in such cases, the error must be clear or manifest the interpretation must be inescapably wrong; the decision must be patently erroneous" and went to pains to explain the suggestion of the circuit court of appeals that this rule reduced it to function ministerially, was erroneous. See also the opinion of Mr. Justice Douglas in *Sancho Bonet Co. v. Texas Co.*, 308 U. S. 463.

In *Bates & Guild Co. v. Payne*, 194 U. S. 106, this court, reviewing a decision of the Postmaster General, said at pages 107, 108:

"But we think that, although the question is largely one of law, determined by a comparison of the exhibit with the statute, there is some discretion left in the Postmaster General with respect to the classification of such publications as mail matter, and that the exercise of such discretion ought not to be interfered with unless the court be clearly of opinion that it was wrong."

Again this court said:

"But there is another class of cases in which the rule is somewhat differently, and perhaps more broadly, stated, and that is, that where Congress has

committed to the head of a department certain duties requiring the exercise of judgment and discretion, his action thereon, whether it involve questions of law or fact, will not be reviewed by the courts unless he has exceeded his authority or this court should be of opinion that his action was clearly wrong."

So in the case at bar, the duty Congress has confided to the Tax Court is not a mere ministerial duty but one involving expert judgment and discretion. It did not intend this judgment to be exercised *de novo* on appeal.

After reviewing and quoting from the cases, this court further said, at page 109:

"The rule upon this subject may be summarized as follows: That where the decision of questions of fact is committed by Congress to the judgment and discretion of the head of a department, his decision thereon is conclusive; and even upon mixed questions of law and fact, or of law alone, his action will carry with it a strong presumption of correctness, and the courts will not ordinarily review it, although they may have power, and will occasionally exercise the right of so doing."

In conclusion this court said (p. 110):

"While, as already observed, the question is one of doubt, we think the decision of the Postmaster General, who is vested by Congress with the power to exercise his judgment and discretion in the matter, should be accepted as final."

That case also quoted from an earlier decision the expression in the *Dobson* case that to reverse, the court must be able to identify a clear-cut mistake of law:

In his excellent article in 35 Harvard Law Review, Professor Albertsworth concludes, at page 149:

"As to the general principle governing judicial review to correct errors of law, it is submitted that, with improvement in the personnel of administrative bodies, decisions of law should come to be reviewed only if palpably erroneous."

Although, as an accounting question, the stock was substituted as a balance sheet liability for the bonds, we do not pitch our argument on the contention an accounting question is involved but on the broader principle that a body of lesser experts should rarely set aside the decision of greater experts and that the Circuit Courts cannot set aside the decision of the Tax Court on the "interpretation of the application of a statute to specific facts" unless it is not a rational application of the statute.

To make the Tax Court a mere agency to certify facts to the Circuit Courts of Appeal for determination of legal questions arising thereon will result in an unbreakable jam there. The whole federal judicial system will suffer the evils of long delay and may even break down. Uncertainty will cause the Tax Court to be flooded with appeals. Its maximum capacity to hear cases is about 1,158 a year (57 Harvard Law Review, p. 914, note 14). The Bureau, for the fiscal year ended June 30, 1943, found 298,475 income and profits tax deficiencies (note 13). The Tax Court also has estate and gift tax jurisdiction and renegotiation jurisdiction over war contracts, as well as jurisdiction to review section 722 cases.

The Ways and Means Committee report on the 1926 Revenue Act stated, "Appeals continue to be filed, averaging about 250 per week." Because of renegotiation, the Tax Court's jurisdiction has been greatly increased and war prosperity and high rates always bring a deluge of

tax cases.² As this court said in the *Dobson* case on page 494:

"Increase of potential tax litigation due to more taxpayers and higher rates lends new importance to observance of statutory limitations on review of tax decisions."

We do not know the capacity of the various Circuit Courts of Appeal to decide cases but some indication of this is offered by the written opinions in the Federal Reporters. For example, 141 F. (2d) covers period from March 7 to April 12. If we count correctly, we find ten

² The general counsel for the Treasury testifying before the Senate Finance Committee, at page 49 of the 1943 hearings, states as follows: "For many years it has been recognized that the volume and complexity of Federal tax cases require a specially qualified and skilled tribunal, such as the Tax Court, which shall devote its entire time and efforts to their consideration and disposition. This need threatens to become even more pressing after the war. The inevitable accumulation of cases during the war and the development of many excess-profits tax cases, particularly those arising under the general relief provisions of section 722, make it obvious that the Tax Court faces a possible post-war crisis, without the addition of complex renegotiation-of-contracts issues to its calendar."

In his letter to the chairman of the Finance Committee, the Presiding Judge of the Tax Court of the United States stated as follows with reference to the renegotiation jurisdiction, which the Revenue Act of 1943 conferred upon the Tax Court (p. 1112): "However, there is a strong probability that a great many cases will come here under the relief provisions of section 722. Broadening of the tax base may be expected to bring more. We also have a few processing-tax cases still to be disposed of. If, in addition, many cases come in under the renegotiation provisions, a serious tie-up of litigation may develop before this court."

opinions of the Fourth Circuit, twenty-two of the Seventh and forty-seven of the Second contained in this volume. Of, course, there will be a volume of other litigation on other Federal questions as well as litigation which always arises from business transactions in a period of prosperity.

While this litigation is going on and while tax questions remain unsettled, business transactions will be delayed. Often appeals are taken to various circuits in the hope of securing a conflicting decision and thus getting the case to this court. For example, the government appealed the question whether claims against an estate were limited to the probatable estate; to six different Circuit Courts of Appeal [88 F. (2d) 338 (C. C. A. 7th); 89 F. (2d) 69 (C. C. A. 5th); 89 F. (2d) 553 (C. C. A. 8th); 90 F. (2d) 745 (C. C. A. 1st); 94 F. (2d) 852 (C. C. A. 2nd) and 103 F. (2d) 1 (C. C. A. 6th)]. The first of these decisions was made February 26, 1937 and the last one was made March 13, 1939. For more than two years the settlement of all estates involving this question and the collection from them of the balance of the tax, which was not in dispute, was held up. In these appeals the respondent found two judges to agree with him in dissenting opinions.

As above noted, 57 Harvard Law Review says the capacity of the Tax Court is about 1158 decisions a year.

The Clerk of that court advises that in 1943 five-hundred-thirteen (513) decisions were appealed to the Circuit Courts of Appeal and to September 1, 1944, four-hundred-sixty-six (466) cases were appealed. Appeals are increasing. Almost half the cases decided are appealed. This is due, in part, to the belief that anything might be decided on appeal. Furthermore, every case appealed holds up the decision in a large number of other cases and other taxpayers

appeal to the Tax Court hoping some Circuit Court of Appeals may decide the issue favorably during the time their case remains on the docket.

At page 786 of his article on the *Dobson* case in 57 Harvard Law Review, page 783, Mr. Paul asserts, "the cure may be worse than the disease" unless the circuit courts are given basic training in distinguishing law from fact. (The adoption of the rule, for which we contend as to review of legal questions, will certainly stem the tide of appellate litigation and remove the troublesome "law and fact" question). At page 798, he asserts a taxpayer may seek the Court of Claims or District Courts to get advantage of a broader appellate review. There is little to this. To do so, he would first have to pay the tax. Also, if he won, he would suffer delay while the government appealed. Taxpayers want matters settled properly and promptly and, if they have a good case, they want it decided by experts. Also, if they lose in the Court of Claims, they have small chance to get certiorari. At pages 803 to 808, he asserts there is no evidence in the committee reports the courts were not to have *carte blanche* to substitute their opinion for that of the Board on legal questions. This is true but it is likewise true there is no evidence in them that Congress did not intend they were not to reverse the Board on law questions unless it was patently wrong. The reports merely say the Courts "may consider the proper interpretation and application of the statute". Of course, no one questions this. Whether they may consider it *de novo* is the question. At pages 842 and 843, he suggests the Tax Court is different from other agencies and the Treasury may be the really expert administrative body. There is nothing to this so far as it touches the question at bar. Every important tax question comes before the Tax

Court for a ruling. Also, while the Treasury is expert, it acts contentiously in the capacity of tax gatherer and not impartially or judicially. It decides doubts in favor of greater revenue. See 18 of Atty. Gen. 246. Also, 53 *Harvard Law Review*, p. 1163. Only when an expert is impartial can he be trusted. Witness the sanity experts who swear on both sides in murder trials. Usually, when the "expertness" of the Revenue Bureau prevails in this court over that of the Tax Court, Congress has set aside this court's decision.³ The *Kirby Lumber Company* case

³ Note 422 on page 844 of Mr. Paul's article contains a collection of decisions of this court which he says the expertness of the Treasury prevailed over that of the Tax Court. The cases in this note support our argument. The *Southwest Consolidated Corporation* case, 315 U. S. 194, was set aside by Section 121 of the 1943 Act and the Tax Court's view established. This was also done in the *Brunn* case, 309 U. S. 461, by section 115 of the 1942 Act. As previously noted, both the *Kirby Lumber Co.* case and the *American Chicle* case, 291 U. S. 426, have been set aside.

Section 215 of the 1939 Act set aside *U. S. v. Hendler*, 303 U. S. 564. The following cases were also set aside by the 1942 Act: *Higgins*, 312 U. S. 212, by Section 121; *Enright*, 312 U. S. 636, by Section 134; *Taft*, 304 U. S. 351, by Section 406; *Crane Johnson Co.*, 311 U. S. 54, by Section 501; *Nemolly Investment Co.*, 313 U. S. 584, by Section 503. Section 134 of the Revenue Act of 1943 set aside *Helvering v. Stuart*, 317 U. S. 154, and Section 502 modified *Estate of Sanford*, 308 U. S. 39. At least twenty other decisions of this court, which have been set aside, could be collected. The *Marr* case, 268 U. S. 536, resulted in the reorganization provisions (see Paul, "Studies in Federal Taxation, 2nd Series" page 4, note 4). Congress had to modify numerous other decisions which would extend this note to undue length to cite. At no time in the court's history have so many decisions on any subject been so promptly set aside by Congress as tax decisions made in the last five years.

is one example. Its "expertness" was recently manifested in its effort to tax stock dividends. He then points out (page 847) the Tax Court is not specially competent on questions of local law, which sometimes decide tax cases. This is true but, instances where local law does this, are so rare in the torrent of tax litigation as to be the exception rather than the rule. The tail cannot wag the dog. The same is true in cases where a common law definition decides a tax case. Also, if the Tax Court decides a local or common law question wrongly, this will be patent and obvious error and thus call for reversal. On page 850, he notes *Helvering v. Brunn*, 309 U. S. 461, failed to uphold the Tax Court but fails to note Congress set this court's decision aside by section 115 of the Revenue Act of 1942. He concludes (page 851) by suggesting this court will probably do as it pleases and infers that courts below should be excused for doing the same. We believe sound public policy prevails here over personal predilections.

As above pointed out, the Treasury acts contentiously in the capacity of a rapacious tax collector and not impartially like the Tax Court. Also, the regulations are *ex parte* and give no reasons. Therefore, more weight should be given to the Tax Court's interpretation of a statute than to a Treasury regulation. The Treasury has promulgated no regulation embracing the specific cancellation question in the case at bar. However, if it had promulgated one, saying there was no cancellation of debt where bonds were exchanged for stock, it is submitted such regulation would clearly be valid. Cf. *Textile Mills v. Commissioner*, 314 U. S. 326, 338; *Magruder v. Realty Corp.*, 316 U. S. 69, 73-74 and cases there cited. See note page 10 hereof. *A fortiori* the Tax Court's interpretation is valid. As said of section 270 by Mr. Paul in his article entitled

"Debt and Basis Reduction" in 15 Tulane Law Review 1, at page 14: "It would be an understatement to call this provision a masterpiece of ambiguity." The requisites of a valid regulations are: (1) that the statute be ambiguous, *Iselin v. United States*, 278 U. S. 280; (2) that it be capable of the construction given it, *Dollar Savings Bank v. United States*, 19 Wall. 227, 237, and (3) that the construction given it be reasonable, *Brewster v. Gage*, 280 U. S. 336. All these reasons operate to sustain the decision of the Tax Court in the case at bar.

Nor is it enough to reverse the Tax Court that the reviewing court, if trying the case *de novo* below, might on the same record have arrived at different conclusions. In *Federal Security Admr. v. Quaker Oats Co.*, 318 U. S. 218, this court said, at pages 227 and 228:

"The review provisions were patterned after those by which Congress has provided for the review of 'quasijudicial' orders of the Federal Trade Commission and other agencies, which we have many times had occasion to construe. Under such provisions we have repeatedly emphasized the scope that must be allowed to the discretion and informed judgment of an expert administrative body. (Citing Cases). These considerations are especially appropriate where the review is of regulations of general application adopted by an administrative agency under its rule-making power in carrying out the policy of a statute with whose enforcement it is charged. (Citing Cases). Section 401, 26 USCA § 341, calls for the exercise of the 'judgment of the Administrator.' That judgment, if based on substantial evidence of record, and if within statutory and constitutional limitations, is controlling *even though the reviewing court might on the same record have arrived at a different conclusion.*" (Italics ours.)

Judicial review of an administrative agency's interpretation of a statute in its application to a specific state of facts (we are not here referring to constitutional or jurisdictional questions or procedural safeguards) does not involve, on the one hand, on the part of the appellate court, a determination de novo or an original determination as if the question had arisen before it in the first instance. On the other hand, the interpretation of the statute by the administrative agency is not conclusive. The scope of Judicial review of the interpretation and application of the statute by the administrative agency rests in a middle ground between these two extremes. That ground may be stated in the form of a rule that, if the construction and application of the statute by the long and widely experienced and highly specialized administrative agency is a reasonable and plausible one and not plainly and beyond reasonable doubt contrary to the terms of the statute, then another interpretation cannot be substituted by the appellate court albeit the appellate court can think of a more reasonable interpretation and albeit it would have construed and applied the statute differently had the same facts come before it as an original trial body.

The reason for this rule is found in the expertness of the Tax Court. It is better staffed and better qualified to decide questions of tax law than most of the Circuit Courts of Appeal. Even this court's decisions on tax questions have at times created chaotic confusion and, on page 23 hereof, is a list of some of them set aside by Congress.

To give the Circuit Courts *carte blanche* to substitute their opinion for that of the Tax Court will eventually result in taking away from the courts all jurisdiction to review it and vesting it in special courts created for this purpose composed of experts. (See testimony of the author of this

brief before the Senate Finance Committee, 1941 Hearings, pages 235 to 237.)

These administrative agencies are not especially expert in fact finding. Their real expertness is in the law they administer. They know its history, the reasons for it and they have the indispensable broad view of its relation to and impact on related questions, which the courts of appeal do not have.

Landis, in "The Administrative Processes," at page 144 says:

"The interesting problem as to the future of judicial review over administrative action is the extent to which the Judges will withdraw, not from reviewing findings of fact, but conclusions upon law. If the withdrawal is due to the belief that these issues of fact are best handled by experts, a similar impulse to withdraw should become manifest in the field of law."

At page 152, he points out the reason the people desire questions of law determined by courts is only to give them the benefit of the opinion of experts. Here the Tax Court is generally more expert than the Circuit Courts of Appeal. In 47 Yale Law Journal, on page 597, the author concludes:

"The courts should not be permitted to search for the correct interpretation of a statute, after an administrative agency has attempted to make such a determination, but should merely inquire as to the reasonableness of the particular determination which has been made."

At page 596 he points out some consequences of the contrary rule.

The foregoing is quoted with approval in the article in

9 George Washington Law Review, page 514. The Court's attention is directed to the exhaustive note in 56 Harvard Law Review, at page 100.

Consider the present situation. The members of the Tax Court, with twenty and thirty years' experience specializing in tax law, consider the facts in a tax case and apply the law to it. An appeal is taken to the Circuit Court of Appeals. A judge, who was a friend of one of the Senators, has just been appointed to that court. His entire experience has been sitting on the bench in a local court in the rural section of Wyoming. He never considered a Federal tax case. One comes before the court for decision. The judges hear the argument and then it is assigned to him to study and write an opinion. He studies the case, writes an opinion and sends it around to the other judges to sign. Sometimes they sign it without reading it. It is then handed down as the decision of the court. A novice substitutes his opinion for an expert's. No wonder there is confusion in tax law. Even if the Tax Court knows a decision is wrong it is influenced by it. In *Commissioner v. Heininger*, 320 U. S. 467, this court observed that the Tax Court was coerced into error by an erroneous decision of the Circuit Court of Appeals. The same thing has happened in many cases.

II.

Considered as an Original Proposition, the Decision of the Tax Court that the Bonds Were Not "Canceled" by Their Exchange for Stock Is Correct.

The argument under this heading is addressed to this Court as if each of its justices were sitting at a trial *de novo* and trying the case as a matter of first impression.

The first rule of statutory construction is that words are to be given their ordinary meaning and taken as the average citizen would understand them. *Avery v. Commissioner*, 292 U. S. 210, 214, and *Addison v. Holly Hill Fruit Producers, Inc.*, 322 U. S.

As stated in the article on section 270 of the statute in 53 *Harvard Law Review*, at page 1009: "In popular parlance no one would ordinarily use the words canceled or reduced in speaking, for example, of conversion of debt into stock in a purely capital transaction." Note Tax Court's reasoning in *Captentol Securities Co.*, 47 B. T. A. at p. 695. Cf. *Alcazar Hotel, Inc.*, 1 T. C. 872.

Under state statutes, a will may be revoked by canceling it. When it is canceled, its legatees take nothing. Here the creditors took substantially the entire property of the debtor in satisfaction of their bonds. If they had been canceled, it would not have been necessary to give them anything and the old corporation could have gone on its way free of debt.

In *Hylteering v. Stockholms Enskilda Bank*, 293 U. S. 84, it is stated:

In *re: Kutzner's Will*, 19 N. Y. S. (2d) 13, 16, the court said:

"The word 'cancel' is derived from the word 'cancelli', crossbars or latticework. Hence as originally used it referred to making cross lines on writing. . . .

There is no doubt that originally the word 'cancel' was confined to the making of cross marks indicating the latticework from which it was derived and grew to be adopted for such purposes in consequence of the fact that in early times few people were capable of writing and therefore were permitted to manifest their intent by drawing lines across the face of the paper."

“ . . . the intent of the lawmaker controls in the construction of taxing acts as it does in the construction of other statutes, and that intent is to be ascertained, not by taking the word or clause in question from its setting and viewing it apart, but by considering it in connection with the context, the general purpose of the statute in which it is found, the occasion and circumstances of its use, and other appropriate tests for the ascertainment of the legislative will. . . . ”

The Tax Court in its opinion in the case at bar concededly correctly stated “Section 268 is an obviously legislative effort to release 77-B reorganizations from the tax burden of the *Kirby Case*, and since Section 270 is manifestly *in pari materia* with it; we have to consider whether this is the sort of situation to which either section was intended to apply.” Cf. *Helvering v. American Dental Co.*, 318 U. S. p. 328, and articles cited in note 8 therein.

Kirby Lumber Co. v. United States, 284 U. S. 1, in which this court sustained the Treasury decision and reversed numerous holdings of Tax Court, is an example of the evils which will result when expert judgment is set aside. That decision of this Court has now been repealed and set aside by Congress, in the words of the committee, to remove a “business deterrent and tax irritant.” (Sec. 114, 1942 Act.) 49 Yale L. J. 1153; 53 Harvard L. S. 977.

The court below (R. 233) purported to “search for the intent of Congress.” Such intent is always found in the proceedings of Congress but it is doubtful if the court below ever looked at the legislative hearings or committee reports. Instead, it merely imagined what the intent of Congress was, as its opinion (R. 233) discloses.

The error of its reasoning is stated in the brief in support of the petition for the writ, at pages 15 to 18, and is not repeated here. The reasoning discloses complete ignorance of the theory of depreciation in tax law and also of the effect of a tax free corporate reorganization.

The history of the legislation discloses the intent of Congress was:

- (1) To relieve debtors from tax, if income arose from the forgiveness of debt, and
- (2) If debtors were relieved of tax, to reduce the basis by such amount.

The Legislative Hearings.

Bankrupts were apprehensive that under the *Kirby Lumber case* the forgiveness or reduction of debt would charge them with a big income tax, which they might be unable to pay. (For complete history see Paul "Debt and Basis Reduction," 15 Tulane Law Review, page 1.)

Section 268 arose from the suggestion of Mr. Banks, member of the National Bankruptcy Committee (see judiciary committee hearings on the revision of the Bankruptcy Act., 75th Congress, 1st Session, pages 266 to 268).

Section 268, as originally contained in the house bill, read: "No income or profit . . . shall be deemed . . . to have been realized . . . by reason of a modification in whole or in part of any indebtedness" (Report House Judiciary Committee, July 29, 1937, p. 111.) There was no provision for basis reduction.

Section 270 arose from the suggestion of Mr. Kent, As-

sistant Chief Counsel of the Treasury, who testified as follows at pages 353 to 354:

"Moreover, we feel that if this remedial provision is written into the law, it should be connected up with a provision for the reduction of the basis of the assets of the debtor to the extent that Congress refrain from taxing income which it would be entitled, under the law, to tax.

"Let me give one or two illustrations to show you how it would operate: Suppose a corporation has been formed for the purpose of putting over real-estate subdivisions. It bought a piece of property at a contract sale price of \$1,000,000. It has paid \$250,000 on that \$1,000,000, and then it gets in trouble and has to reorganize. As a result of that reorganization the indebtedness of that property is written down by the vendor from \$750,000 to \$500,000. Having reorganized, and conditions having improved, the corporation goes on and is able to sell its subdivision on a profitable basis. Now, under this provision as now written in the bill, the Bureau of Internal Revenue would be precluded from asserting any income-tax liability by reason of the \$250,000 cancellation of indebtedness in the reorganization proceeding. Yet, isn't it perfectly apparent that all that the corporation paid for its property, assuming that in due course the \$500,000 is paid off, is \$750,000; and if it markets the property for \$1,500,000, its profit is \$750,000 less expenses, and not \$500,000 less expenses.

"The draft which the Treasury Department is submitting for your consideration would make the basis in such a case \$750,000.

"That seems to us to be the most fair and equitable solution; both from the point of view of revenue and from the point of view of the taxpayer, it is possible to work out."

The foregoing plainly shows that the Treasury was considering a case of forgiveness of debt and not a case of

exchange of stock for bonds. It harmonizes with our construction of the statute on page 39 hereof.

The Committee Reports.

The committee reports likewise sustain the contention, that only cases of forgiveness of debt, excluded from tax by Section 268, were embraced within the section. Senate Report No. 1916; 75th Congress, page 7, states:

"20. Income-tax exemptions. (Sec. 268, p. 176.)

The Committee has adopted revised language as submitted by the Treasury Department, precluding tax assessments resulting from the scaling of indebtedness on the basis of a write down in the valuation of a debtor's assets, without an actual sale or exchange of such assets. Such an exemption is in accordance with the fundamental objective of debt readjustment."

"21. Basis of property. (Sec. 270, p. 177.) This provision is intended to prevent a double deduction. Where *debt forgiveness* resulting from a debt readjustment is exempt from tax upon income or profit, the cost of the property dealt with by the settlement is to be decreased *for future tax purposes*, by an amount equal to the amount of the indebtedness canceled or reduced in the proceeding." (Italics ours.)

The Senate Judiciary Committee report also reads as follows (S. Rep. No. 1916, 75th Cong., 3d Sess., p. 39):

"Sections 268, 269, and 270 are intended to preclude tax assessments resulting from the scaling of indebtedness on the basis of a write-down in the valuation of a debtor's assets, without an actual sale or exchange of such assets. Section 270 avoids the possibility of any double deduction. Where *debt forgiveness*, resulting from a debt readjustment, is exempt from tax upon income or profit, the cost of the property dealt with by the settlement is to be decreased, *for future tax purposes*, by an amount equal to the amount of the indebtedness canceled or reduced in the proceeding." (Italics ours.)

The foregoing plainly and bluntly states that where forgiveness of debt is excluded from tax by section 268, section 270 is intended to reduce the basis of property by the amount thus excluded. Also section 276 (c) (3) (page 56) considers sections 268 and 270 to be interdependent. (The Court below considered them together. See R. 234, 235.) Note the words "for future tax purposes."

When the 1940 amendment was under consideration, it was proposed that it provide the basis be only reduced by the amount freed from tax by section 268. However, in some cases indebtedness had been reduced by so many millions (the tax status of which was in doubt under the *Kirby* case) that such a provision would leave some corporations with a zero base. They objected to it and demanded instead, a provision that the reduction not go beyond market value. This was adopted.

In the case at bar, there is no amount thus excluded from taxable income. The Tax Court found that the transaction was a non-taxable reorganization and respondent accepts that conclusion. The bondholders were unable to deduct any loss (section 112 (b) (3) I.R.C.) (*Burnham v. Commissioner*, 86 F. (2d) 776, cer. den. 300 U. S. 683, and *Helvering v. Cement Investors*, 316 U. S. 527) and neither corporation realized either income or loss (112 (b) 4). See note in 87 L. ed. page 817, 818, *Hummell-Ross Fibre Co. v. Commissioner*, 46 B.T.A. 821. Why would Congress impose the burden of section 270 on a bankrupt when it had no benefit from sec. 268?

The court below construed the statute to mean that the basis was to be reduced by the amount of debt reduction excluded from tax by section 268 but erroneously assumed

that Section 268 excluded from tax what otherwise would have been taxable income (R. 236). (See our brief in support of petition, p. 13.) It said: "We are relieving an involved debtor from an income tax" (R. 236). It erred because it did not know that no tax arose where the transaction fell within the Revenue Act's definition of reorganization as it did here.

Departmental Interpretation.

The regulation of the Treasury (Appendix)—does not define debt cancellation and is of no assistance in solving the question at bar. This court has repeatedly decided that rulings of the Treasury, which are not regulations, do not have the weight of regulations. *Helvering v. New York Trust Co.*, 29 U. S. 455, 468; *Biddle v. Commissioner*, 302 U. S. 573, 582. Also, on whether debt is canceled in a transaction such as this, the Bureau ruled the other way closer to the date section 270 was enacted.

In the spring of 1938, the question arose as to whether, under the proposed plan of reorganization, a Boston Trust would realize a profit from the surrender of all the bonds of the taxpayer in exchange for its stock. This question held up the confirmation of the plan until it could be answered. An attorney from Boston wrote the Commissioner for a ruling on March 2, 1938. On May 13, after a lapse of seventy days, he received a careful and considered answer from the Commissioner which bears evidence of close and painstaking analysis of the question propounded, and is set forth in the appendix B hereof at page 59. The Commissioner stated:

"Under the facts presented, and as above outlined, it does not appear that there is involved in the plan any question of the cancellation of indebtedness. In

each instance with the exception hereinafter noted where an indebtedness of the corporation is involved, and is being extinguished it is to be effected through an exchange and a payment of the indebtedness, rather than through cancellation of the indebtedness, the consideration being the exchange of its new convertible preferred shares and common shares for its first and second mortgage bonds, and the accrued interest thereon. The same situation exists with respect to the satisfaction of the unpaid compensation due trustees which had accrued prior to January 1, 1933. The trustees accept the common stock in payment and discharge of their claim. It is, therefore, the opinion of this office that no taxable income will be realized by the taxpayer by reason of these transactions."

In reliance on the above ruling, the Substitute Plan of Reorganization was promptly confirmed and carried out in full.

In 1941 the Bureau published G.C.M. 22528, C.B. 1941-1, at page 193, in which it expressed the opinion that the law was as contended by respondent here and as held by the court below and contrary to the above ruling.

This expression of the opinion falls within the class of rulings considered in the two decisions of this court last above cited. It is an example of rulings which this Court, in the cases cited at page 35 hereof, holds entitled to little weight.

When the Revenue Act of 1943 was under consideration, taxpayers emphatically protested the Commissioner's construction and that of the court below to Congress and, in Section 131 (c) (3) and (e), Congress repealed Section 270 but such repeal operates prospectively only. In his speech on the presidential veto, Senator Barclay stated that

whether the repeal would mean anything would depend on the outcome of the cases now in the courts. Repeal may have been unnecessary but it was made out of an abundance of caution. In other words, a Congress composed of a majority of the same men who composed the Congress which enacted section 270 recognized the injustice of respondent's contention and nullified it. This shows Congress did not have the intention imagined by the Circuit Court of Appeals in the decision below.

By section 215 of the Revenue Act of 1939, c. 247, 53 Stat. 862, Congress adopted somewhat similar provisions to apply to corporations (other than those in bankruptcy) in "unsound financial condition." *Helvering v. American Dental Co.*, 318 U. S. at p. 329.

The Committee report explained section 22 (b) as follows (for report see C. B. 1939-2, p. 522):

"The new paragraph provides that the amount of income of a corporate taxpayer attributable to the discharge within the taxable year of its indebtedness or indebtedness for which it is liable (as, for example, in the case of a debt arising from an assumption of liability of another corporation) is to be excluded from gross income, provided (1) the Commissioner is satisfied that such taxpayer was at the time of such discharge in an unsound financial condition and (2) such taxpayer consents to regulations prescribed under the new section 113 (b) 3 of the Code, relating to reduction of basis in effect at the time of the filing of the return."

It explains section 13 (b) (3) as follows:

"As a corollary to the amendment made by subsection (a), subsection (b) adds a new paragraph (3) to section 113 (b) of the Internal Revenue Code, relating to the adjusted basis of property. The new

paragraph provides that *if an amount is excluded from gross income of a corporate taxpayer under the amendment made by subsection (a), the basis of the taxpayer's property held by it at any time during the taxable year in which a discharge of indebtedness occurred shall be subject to reduction.*" (Italics ours.)

This court will observe it applies to corporations not in bankruptcy and the basis was to be reduced only in cases where debt reduction resulted in income which would otherwise be taxable except for the provision exempting it and it was optional with a taxpayer whether to avail itself of the exclusion provision. If it did not elect to do so the basis provision did not apply. In other words the reduction was limited to income excluded by the section from tax.

The Ways & Means Committee report, however, stated:

"Wherever a discharge of indebtedness is accomplished by the transfer by the debtor of property in kind, such as by the issue of its own stock, the difference between the amount of the obligation discharged and the value of the property transferred is the amount which may be excluded from gross income and applied in reduction of basis."

The court will note the Judiciary Committee and not the Ways & Means Committee was in charge of the legislation involved in the case at bar. No decision has ever held the report of a committee not in charge of a bill and addressed to a different bill is a competent one on the construction of a bill to which it was not addressed and does not refer. The Committee report stated of the amendments: "They likewise do not apply to any discharge of corporate indebtedness occurring in any proceeding under section 77 B" (or under the Chandler Act) "since such

discharges are governed by other provisions of law." See *Helvering v. American Dental Co.*, 322 U.S. p. 329. There is no evidence the Senate Finance Committee thought this Act meant what the Ways & Means report stated. (For Senate Report see C.B. 1939-2, p. 527.) There was no conference report on this act.

Of course, the case at bar is not within the above example because this taxpayer was not the debtor and the example refers to an issue by the debtor "of its own stock." Furthermore, such case would usually not come within the 1939 amendment at all because such issue would usually be in connection with a recapitalization, which is a tax free reorganization. (*Capento Securities Co.*, 140 F. (2d) 382, and *Hoagland Co.*, 121 F. (2d) 962, and many other cases.) In such case there is no income to exclude from tax by Section 22 and the 1939 basis amendment is not applicable. Had what was done in the case at bar been done outside 77B, this 1939 amendment would not touch the case. Taxpayer should be in no worse position merely because it was done under 77B.

Meaning of the Words "Canceled or Reduced."

A cancellation occurs when an indebtedness is not accorded recognition in a plan of reorganization and a reduction occurs only when the indebtedness is accorded recognition in a reduced amount. Where recognized to the extent of its full amount the debt has not been "reduced or cancelled" regardless of the nature of the provisions with respect thereto. No question of reduction is here.

In virtually every reorganization the value of the property is less than the face amount of debt yet the full amount of the senior debt is recognized by issue of stock and the

junior debt canceled. Also, in most large reorganizations, secondary bond or note issues were canceled and not recognized. The value of the property and the actual value of the senior debt are the same in cases where the debt accorded recognition takes the entire property.

In cases where the value of the property is not in excess of the first lien debt, no provision for secondary debt is made and it is thereby canceled. If the value of the property exceeds the first lien debt, but doesn't equal the junior debt, the second debt is often recognized only in part.

If Congress had intended that debt fully recognized in a reorganization and exchange for stock be considered "cancelled or reduced" it could have precisely said so, leaving no room for doubt and uncertainty. The Committee reports on page 33 hereof, show it had in mind forgiven debt.

Furthermore, the hearings and committee reports show beyond doubt the purpose of the statute was to compensate the Treasury for tax lost by section 268 and, if there was no tax so lost, there was to be no reduction in basis. Even if the statutory words were to the contrary (which they are not) this court has often "followed the purpose rather than the literal words." *Trucking Associations*, 310 U. S. 541, 543, 544, and *United States v. Rosenblum Truck Lines*, 315 U. S. 50, 55. The same purpose is found in the basis income tax amendment discussed at page 38 hereof which beyond dispute only applies where income is freed from tax.

While there might have been a court reorganization under section 77 B out of which taxable income and tax consequences arose to all concerned (Cf. *Helvering v. South-*

West Consolidated Co., 315 U. S. 194) the Tax Court held this a tax free reorganization and consequently there was nothing for section 268 to free from tax. The Tax Court said (R. 197):

"Both gain or loss and depreciation to the new corporation can appropriately be measured by the old basis without doing violence either to the tax consequences of the reorganization or to the doctrines upon which those consequences rest."

The court below failed to appreciate this and both this taxpayer and "the tax system suffers from the lack of a roundly tax informed viewpoint of the Judges." *Dobson case*, p. 500. They overlooked both the theory of depreciation and the reorganization provisions.

When it is considered the purpose of the bankrupt law is to help the bankrupt get a fresh start and not to give its solvent competitors an advantage, surely Congress did not intend to burden it with the heavy burden of section 270 when it had no benefit from section 268. The decision of the court below accepted this reasoning but, because it apparently did not know the tax consequences of a reorganization, it erroneously said section 268 relieved the debtor from a tax. (See quotation in brief in support of petition for writ, p. 16.)

In *Helvering v. Cement Investors*, 316 U. S. 527, this court said, at p. 532:

"The ownership of the equity in these debtor companies effectively passed to these creditors at least when 77 B proceedings were instituted."

Here the ownership of the corporate assets passed to the bondholders on October 1, 1931. From that date their

bonds were evidence of their ownership. On May 14, 1935, they exchanged these bonds for corporate stock—another evidence of ownership of the same assets. This exchange was a non-taxable transaction. *Burnham v. Commissioner*, 86 F. (2d) 776, cer. den. 300 U. S. 683; *Helvering v. Cement Investors*, 316 U. S. 527. Every cash dollar which the debtor had secured for these bonds to build the apartment building was still in it. It was hard cash not “make believe water values.” The cost of the building remained unchanged for tax purposes because, in a reorganization, the transferor’s basis carries over to the transferee. *Palm Springs Holding Co. v. Helvering*, 315 U. S. 185. It is obvious from the opinion of the court below that it thinks depreciation is based on the present market values whereas it is based on the cost. (See page 11, petition for the writ herein.) During the depression, most values were below cost. The theory is, recovery of cost is not income.

In a case where a solvent corporation exchanged stock for bonds (different from the case here because bonds in a solvent corporation do not represent equitable ownership of its assets) the court below, in an opinion by the same Judge (*Chicago, Rock Island & Pacific Ry. Co. v. Commissioner*, 47 F. (2d) 990, cer. den. 384 U. S. 618) said at 47 F. (2d), page 992:

“Had petitioner paid off its bonds in cash at par, a loss would have occurred. Instead of paying off these bonds in cash, however, petitioner issued its stock to retire them. The stock was not worth par any more than the bonds were worth par. Petitioner’s bonds were a liability. So was its capital stock. It exchanged one liability for the other. Presumably they were of the same value.” See 40 Col. Law R. p. 1336.

Consequences of Upholding the Construction Adopted by the Court Below.

Consider the absurd consequences of the decision below. You invest \$500,000. in all the bonds of a corporation and it builds an apartment house with this \$500,000. Values shrink in a depression and you exchange your bonds for stock worth \$100,000. at market but, the transaction being a non-taxable reorganization, neither you nor the old or new corporation realizes any profit or loss. A boom time comes and the new corporation sells the building for cost less depreciation, say for \$350,000. Under the holding of the court below, it has a taxable profit of \$250,000. You can never recover your investment. The effect is to tax the capital invested by you as income. It is submitted Congress never intended such absurd results. It never proposed to turn an income tax into a capital levy. The situation it sought to reach is the one contained in the example given by Kent and quoted at page 32 hereof. Furthermore, the construction of the court below creates an indefensible discrimination between 77 B and other reorganizations. Under this construction, when the plan was confirmed in 1935 and final decree entered March 1, 1937, the corporation was unquestionably entitled to use its predecessor's base but according to respondent Congress later imposed a retroactive burden on former bankrupts not imposed on rich corporations reshuffling their capital structure by an identical substitution of stock for bonds. In the words of this court in *Miller v. Nat. Margarine Co.*, 284 U. S. 489, 510, "such discrimination conflicts with the principle underlying the constitutional provision directing that exactions laid by Congress shall be uniform throughout the United States."

Also, no reason, rational or irrational, can be suggested why Congress should have wanted to do any such thing.

As Mr. Paul points out in his article in 15 *Tulane Law Review*, at page 7, Mr. Chandler, who was in charge of the bill, thought section 270 only reduced the basis to the extent income was relieved of tax by section 268 and blamed the confusion on the Treasury.

The statement of the court below that capital stock is not a debt is another straw man and false issue wholly immaterial to any question here presented. No one ever asserted it was a debt. The Tax Court was correct in terming it a liability. *Helvering v. Canfield*, 291 U. S. 166, wherein this court said surplus is "the amount of net assets over liabilities including capital stock." The word "liability" is much broader than the word debt. Capital stock represents the liability of the issuing corporation to its shareholders. It owes them everything.

The decision below not only puts a burden on bankrupts, not put upon solvent corporations exchanging stock for bonds but makes it necessary to make an administrative valuation in every bankruptcy case (of no use after 1943 because of the repeal of section 270 by the 1943 Act) and also an allocation of the debt to different items of depreciable property having different rates of depreciation and thus sows the seeds of litigation in every such case.

Section 270 Is Not Retroactive So as to Effect Tax Liability Prior to the Year of Its Enactment.

The words of the Statute, relied on by respondent, are (Appendix 56, 57):

This article by Mr. Paul is a later and more seasoned consideration of the question than appears in *Studies in Federal Taxation* (3rd series) at pages 147 to 156.

"(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date."

The court below, reversing the Tax Court, quotes these words in its opinion and states:

"Given their ordinary meaning the words 'before the effective date of this amendatory Act' mean that it, the Act, applies to reorganizations which were completed before June 22, 1938."

In so holding the court below decided a false issue not in dispute and not an answer to this issue. Also, the statute does not refer to "reorganizations completed" but to "plans confirmed". They are often confirmed long before reorganizations are completed.

Of course, the Act applies to 77B plans confirmed before its enactment. Everyone admits that and it was not even an issue in this case. (At page 47 we raise the issue whether such confirmed plans must have been in cases pending when it was enacted.) The question under this heading is not whether it applies to plans already confirmed. Assuming it does, the question is whether it applies to such plans for past tax years? The court below missed the point that this was the question.

The decision of the Tax Court in this case was that it applied to this plan although confirmed before the Act was passed. That is the most anyone can read the Act to say. It does not say it applies retroactively in computing tax liability or that it applies in computing the tax liability for years prior to the year of its enactment. At most, it says

that from the year of its enactment it applies in computing tax liability of "any plan confirmed before the effective date of this amendatory Act". (Whether the Statute limits this to pending cases is discussed on page 47 hereof.)

A reading of the opinion of the court below discloses it does not touch this issue. It decides a false issue—a point conceded by all and assumes it determines the case.

In a very carefully considered opinion in *The Commodore*, 46 B.T.A. 717, at page 723, the Board of Tax Appeals quoted the report of the Senate Judiciary Committee that section 870 applies "for future tax purposes" and so held, as it also held in the case at bar. The Board was affirmed in *The Commodore* case by the Sixth Circuit in 135 F. (2d) 89, which also relies on the committee report.

Apparently the learned court below, when it "searches for the intent of Congress" (R. 233) does not look at committee reports. As this court observed in *American Dental Co.*, 318 U. S. 322, at page 329, the related income tax provision discussed at page 37 hereof, was not retroactive. Why would Congress want to make this retroactive?

Rules of construction here applicable have been stated by this court as follows:

In *Schwab v. Doyle*, 258 U. S. 529, this court, at page 534, quoted Justice Story as follows:

"Retrospective laws are, indeed, generally unjust; and as has been forcibly stated, neither in accord with sound legislation nor with the fundamental principles of the social compact."

In *Union Pacific Railroad Co. v. Laramie Stock Yards Co.*, 231 U. S. 190, the court said, at page 199:

"Construction, therefore, becomes necessary, and the first rule of construction is that legislation must be considered as addressed to the future, not to the past. The rule is one of obvious justice, and prevents the assigning of a quality or effect to acts or conduct which they did not have or did not contemplate when they were performed. The rule has been expressed in varying degrees of strength, but always of one import, that a retrospective operation will not be given to a statute which interferes with antecedent rights, or by which human action is regulated, unless such be 'the unequivocal and inflexible import of the terms, and the manifest intention of the legislature'. (Citing cases.)"

Every presumption is indulged against retroactive construction and an act will be so construed only when there is no reasonable escape from such construction.

Congress has never imposed additional taxes retroactively as far back as five years past unless it has done so in this instance and there is a constitutional doubt whether it can do so, yet respondent asks the court to construe the act as imposing a retroactive tax on Federal bankrupts not imposed on any other corporation. It is submitted this would be an absurd construction.

Section 270 Does Not Apply to Proceedings Not Pending When It Was Enacted Because Final Decrees Had Been Entered Long Prior Thereto.

The Tax Court did not decide the question we raise here and it is necessary to decide it because of the holding below on the interest cancellation.

In the case at bar the plan was confirmed under section 77B, May 14, 1935 (R. 187) and the final decree was entered March 1, 1937 (R. 187): The Chandler Act was enacted

June 22, 1938 and became law September 22, 1938. The report of the Senate Judiciary Committee states on page 39 thereof:

"Article XVI. When Chapter Takes Effect.—Section 276 keeps section 77 B operative, except as noted below, with respect to proceedings pending when this chapter takes effect. This chapter is made applicable in its entirety to proceedings in which the petition was approved not more than three months before this chapter becomes effective. In these cases, the courts and the parties have ample notice of the provisions of this chapter since the Act does not take effect until three months after it is signed."

In all legislation the problem arises to what extent it shall be applied in pending proceedings. The legislature does not usually consider its application to cases long closed by final decree.

Section 270, read by itself, does not apply to any proceeding except "a proceeding under this chapter", Chapter X added by the Chandler Act. (See 46 B.T.A. at p. 723.) By itself, it does not apply to this 77B proceeding.

If it applies to proceedings under section 77B, long since closed by final decree, such application must clearly be spelled out of the following language of the statute:

"Section 276.

"(c) the provisions of section 77A and 77B of chapter VIII as amended, of the Act entitled 'An Act to establish a uniform system of bankruptcy throughout the United States', approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

"(1) if the petition in such proceedings was approved within three months prior to the effective date

of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

"(2) if the petition in such proceeding was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

"(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77 B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77 B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had, for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient." (U. S. C. 1940 ed., Title ii, Sec. 676.)

It is submitted the above statute refers in the first paragraph of (c) above "to proceedings pending" under 77B and that exceptions (1), (2) and (3) are keyed into this first paragraph and refer to pending proceedings also. They merely except from the *pending cases* those to which 77B is not to apply. Since (c) deals only with pending cases and not closed cases, they refer also to pending cases.

If a plan had been already confirmed in a pending proceeding, it could be vacated (Sec. 77B, subdivision (f)) and reformed so as to be framed in the light of section 270 and make it comply with the provision of the Act that it be fair to all parties and feasible. Also, any case closed in 1934, would have been closed without benefit of section 268, taxes paid and claims for refund barred. Since Congress intended neither section should apply except where the other

did, it could not have intended section 270 to apply to such plan.

(The crucial statutory language is section 77B shall apply "with respect to proceedings pending, except." Therefore, these exceptions to which the Chandler Act applies are only talking about pending cases.

CONCLUSION.

The decisions of the Tax Court on the interpretation and application of a statute to specific facts are not conclusive. On the other hand, that court has not been vested by Congress only with the duty of finding facts and certifying them to Circuit Courts of Appeal to have the legal questions arising thereon determined therein *de novo*. Congress provided the Tax Court should decide legal questions arising on the facts. The Ways & Means Committee, in its report on the 1926 Act, referred to the Tax Court members as "experts in the field of tax law."

In providing the Courts of Appeal might reverse the Tax Court decision where it was "not in accordance with law", Congress obviously intended it must be so palpably and beyond doubt. This is implicit in the appellate procedure. If the decision of the Tax Court rests on a rational basis it must be sustained. The reason provision is made for the decision of questions of law by judges is solely that they may be determined by experts. The average Tax Court Judge is a greater expert in tax law than the average Judge of a Circuit Court of Appeals. The opinion of the Court of Appeals in the case at bar is one more exhibit offered to prove this assertion. The 1926 Ways &

Means Committee report also states: "The Committee is of the opinion that the great value of the Board lies in its practice of meeting regularly for common consideration and discussion of opinions prepared and proposed to be issued." It has sixteen pages.

◆ If this court should declare the rule for which we contend, we fear lip service only will be given it below unless it is emphasized by language such as found in *Sancho Bonet Co. v. Texas Co.*, 308 U. S. 463, where this court said at page 471:

"We now repeat once more that admonition. And we add that mere lip service to that rule is not enough. To reverse a judgment of a Puerto Rican tribunal on such a local matter as the interpretation of an act of the local legislature, it would not be sufficient if we or the Circuit Court of Appeals merely disagree with that interpretation. Nor would it be enough that the Puerto Rican tribunal chose what might seem, on appeal, to be the less reasonable of two possible interpretations. And such judgment of reversal would not be sustained here even though we felt that of several possible interpretations that of the Circuit Court of Appeals was the most reasonable one. For to justify reversal in such cases, the error must be clear or manifest; the interpretation must be inescapably wrong; the decision must be patently erroneous."

On the second point, if the debt of the transferor corporation had been really "canceled" it would have emerged from bankruptcy free of debt, its stockholders would have been its sole owners and it could have continued business. Instead of canceling its debt, its creditors took its property away from it and conveyed it to taxpayer. If one cancels our debt, we are better off. If a corporation's debt is "canceled" its stockholders are better off. They would

have been here if it had been canceled but, it was not and they lost everything. Maybe we will cancel England's debt after the war. Maybe we will get territory for it as some senators now advocate. If a presidential candidate were to say we should cancel it, the average voter would understand he meant forgive it and not take Bermuda and other territory for it.

If the court concludes the word "canceled" (no question of debt reduction arises in this case) means forgiven, then section 270 has no application to this case and the decision of the Tax Court must be affirmed on this point and that of the court below reversed.

On the other hand, if this court concludes the debt was "canceled" and the statute, if read literally, applies, then it is submitted the court should follow the purpose of the statute rather than the literal words (*United States v. American Trucking Associations*, 310 U. S. 541, 543, 544). The legislative history shows the purpose of section 270 of the Chandler Act was to compensate the government for tax lost by reason of the application of section 268. If section 268 did not save a debtor from tax, then section 270 was not to reduce the basis of its property. As pointed out by Mr. Paul in *Debt and Basis Reduction*, 15 *Tulane Law Review*, I, in note 26, on page 7, Congressman Chandler thought this was the construction of the Act. He has stated this was the intent of Congress. Also, as pointed out by Mr. Paul in note 11, on page 3, of this article, Congressman Chandler blamed the confusion on the Treasury. Potent reasons support this construction. The conceded purpose of the Chandler Act was to facilitate and not impede federal bankruptcy reorganizations and, to quote from page 7 of Mr. Paul's aforesaid article: "No reduction of

basis was required in cases in which stock of the debtor or its transferee was issued for bonds—a common type of reorganization protected from recognition of gain by the Internal Revenue Code—and it does not seem reasonable that Congress could have intended in the Chandler Act to penalize expedient reorganizations which could have been freely undertaken outside of bankruptcy.”

If the bonds had been exchanged for stock outside of bankruptcy, the old basis would have carried over. *Palm Springs Holding Co. v. Helvering*, 315 U. S. 185.

This court has often declared the rule that bankruptcy acts are to be literally construed and that “possible doubt as to the meaning of the section should be resolved in the light of the purpose of the act . . . to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh, free from obligations and responsibilities consequent upon business misfortunes” (Citing Cases) *Maynard v. Elliott*, 283 U. S. 273, 277. Moreover, the statute was intended to remedy the doubt arising from the *Kirby* case and a remedial statute should be construed “to give the relief it was intended to provide” *Bonwit, Teller & Co. v. United States*, 283 U. S. 258, and finally “if doubt arises as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer” *Hassett v. Welch, Collector*, 303 U. S. 303, 314.

Congress was not passing a statute to require that tax returns of bankrupts be reopened and additional tax recomputed back to 1934. Returns for that year were due March 15, 1935. The three year statute of limitations expired March 15, 1938. This law was enacted June 22, 1938. If any tax had been paid on debt cancellation in 1934, its recovery was barred when this law was enacted. If con-

gress had intended the provision to be retroactive, it would have suspended the statute of limitations in such case.

Finally, the statute can well be construed not to apply to cases closed by final decree before it was enacted because section 276 (c) says "with respect to proceedings pending under those sections upon the effective date of this amendatory Act except" and the exceptions are carved out of "proceedings pending . . . upon the effective date of this amendatory Act." This was not one.

The court below held its decision debt was canceled rendered certain questions in case No. 29 moot: Should this case No. 28 be reversed they are not moot and case No. 29 should be reversed with directions to consider them in the light of this opinion.

All of which is respectfully submitted.

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APPENDIX.

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancelation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter.

(U. S. C. 1940 ed., Title 11, Sec. 668.)

Sec. 269. Where it appears that a plan has for one of its principal purposes the avoidance of taxes, objection to its confirmation may be made on that ground by the Secretary of the Treasury, or, in the case of a State, by the corresponding official or other person so authorized. Such objections shall be heard and determined by the judge, independently of other objections which may be made to the confirmation of the plan, and if the judge shall be satisfied that such purpose exists, he shall refuse to confirm the plan.

(U. S. C. 1940 ed., Title 11, Sec. 669.)

Sec. 270. [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) as is

transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section.

(U. S. C. 1940 ed., Title 11, Sec. 670.)

Sec. 276. . . .

c. the provisions of section 77A and 77B of chapter VII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

(3) sections 268 and 270 of this Act shall apply to

any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient.

(U. S. C. 1940 ed., Title ii, Sec. 676.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934, as amended by T. D. 4871, 1938-2 Cu. Bull. 130, and T. D. 5003, 1940-2 Cum. Bull. 107:

Art. 113 (b)—2. Adjusted basis: Cancellation of indebtedness.—In addition to the adjustments provided in section 113 (b)(F) and article 113 (b)—1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any proceeding under section 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B or under Chapter X, XI, or XII of the Bankruptcy Act of 1898, as amended.

For the purpose of this article—

(A) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(B) Except where the context otherwise requires, property means all of the debtor's property other than money;

(C) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return;

(D) The phrase "indebtedness incurred to pur-

chase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay; and

(E) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which said indebtedness shall have been canceled or reduced.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this article.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this article.

Article 113 (b)—2, Treasury Regulations 94, as amended by the same Treasury Decision, is identical with the above quoted article.

APPENDIX B.

**"TREASURY DEPARTMENT
Washington**

Office of
Commissioner of Internal Revenue
Refer to:
IT:RR:CAB

May 13, 1938

Mr. Harry Bergson, Attorney at Law,
31 State Street,
Boston, Massachusetts.
In re: Motor Mart Trust.

Sir:

Further reference is made to your letter of March 2, 1938, and enclosures ("SUBSTITUTE PLAN OF REORGANIZATION PROPOSED BY DEBTOR DATED SEPTEMBER 13, 1937") in which a ruling by this office is requested as to whether or not Motor Mart Trust (hereinafter called the taxpayer) will incur any income tax liability by reason of its proposed reorganization under Section 77B of the National Bankruptcy Act, as amended, under the substituted plan of reorganization presented to the District Court of the United States for the District of Massachusetts. It is stated that the plan has not been confirmed by the court for the reason that prior to such action the taxpayer desires to be assured that no taxable income will accrue to it as a result of the plan of reorganization.

In its petition for reorganization filed with the District Court the taxpayer states that it is a voluntary association under a written declaration of trust executed March 1, 1926 with beneficial interests divided into transferable shares and is a corporation within the meaning of the National Bankruptcy Act.

The substituted plan of reorganization shows the

taxpayer to have had the following outstanding capital liabilities on the date of filing the petition;

First Mortgage Bonds in the sum of \$1,193,500.00 and accrued interest thereon in the sum of \$298,375.00; Second Mortgage Bonds in the sum of \$282,000.00, with accrued interest thereon of \$101,990.00; 1,250 shares 8 percent cumulative preferred stock par value \$100.00; and 5,000 shares class B common stock of no par value. It also shows outstanding scrip certificates dated May 16, 1932 due August 1, 1934 in the sum of \$60,750.00 representing interest on certain of the first mortgage bonds due September 1, 1932 and March 1, 1933 and not paid in cash. It further shows unpaid trustees' compensation in the sum of \$68,651.77, accrued prior to January 1, 1933. The letter of the representative of the taxpayer states, however, that the total face value of bonds affected by the proposed plan is \$1,475,500.00 and the amount of unpaid interest thereon up to March 1, 1938 is \$471,490.00.

The proposed plan is that all of the foregoing securities and debts be paid and retired by the taxpayer issuing 9,548 shares of convertible preferred of the par value of \$50.00 per share and 6,437 shares of common of the par value of \$5.00 per share. The convertible preferred under the terms of the plan are convertible at any time prior to January 1, 1944 into common shares of the taxpayer.

It is proposed that the holders of the first mortgage bonds shall receive under the plan for each one \$1,000.00 first mortgage bond accompanied by coupons payable on or after September 1, 1933 eight convertible preferred shares and four common shares of the taxpayer. Holders of first mortgage bonds of the denomination of \$500.00 accompanied by coupons as aforesaid shall receive four convertible preferred shares and two common shares. The holders of the second mortgage bonds are to receive under the plan for each one \$1,000.00 second mortgage bond accompanied by coupons payable on or after September 1, 1932 five common shares of the taxpayer. Holders of second

mortgage bonds of the denomination of \$500.00 accompanied by coupons as aforesaid shall receive two and one-half common shares. The holders of the present common and preferred stock of the taxpayer will not receive anything under the plan, their interest being entirely wiped out, the effect of the plan being to make the present bondholders the new beneficiaries of the taxpayer.

The trustees for their claim of \$68,651.77 for compensation accrued prior to January 1, 1933 are to receive 253 common shares of the taxpayer.

It is proposed that the holders of scrip certificates, above referred to, are to be paid \$2.00 for each certificate of the face value of \$30.00 and \$4.00 for each certificate of the face value of \$60.00 or a total in cash of \$5,050.00.

It is further proposed that any merchandise or miscellaneous creditors who may properly establish their claims will be paid in full.

In the exchange of convertible preferred shares and common shares for first and second mortgage bonds, and accrued interest thereon, no attempt is to be made to allocate the amount of stock being given in exchange for the principal of the bonds and the amount given for the accrued interest due thereon.

The representative of the taxpayer further states that in the past the taxpayer has used the accrual basis of keeping its records and reporting its income and has deducted from its annual income the amount of the accrued interest on the bonds although such interest was in fact never paid. However, the taxpayer would not be chargeable with any taxable income for the years in which these accruals were deducted for the reason that after normal allowances for depreciation there would still exist a deficit greater than the amount of the interest on the bonds.

Under the facts presented, and as above outlined, it does not appear that there is involved in the plan any question of the cancellation of indebtedness. In each instance with the exception hereinafter noted

where an indebtedness of the corporation is involved and is being extinguished it is to be effected through an exchange and a payment of the indebtedness rather than through cancellation of the indebtedness, the consideration being the exchange of its now convertible preferred shares and common shares for its first and second mortgage bonds, and the accrued interest thereon. The same situation exists with respect to the satisfaction of the unpaid compensation due trustees which had accrued prior to January 1, 1933. The trustees accept the common stock in payment and discharge of their claim. It is, therefore, the opinion of this office that no taxable income will be realized by the taxpayer by reason of these transactions.

Concerning the purchase of \$60,750.00 of scrip certificates which had been issued in payment of interest on certain first mortgage bonds due September 1, 1932 and March 1, 1933, for the sum of \$5,050.00, cash, or at the rate of \$2.00 for each certificate of the face value of \$30.00 and \$4.00 for each certificate of the face value of \$60.00, it does not appear from the information submitted for what taxable years this scrip was issued in payment of interest on its bonds. It is assumed, however, since it is stated that taxpayer has used the accrual method of keeping its records and filing its income tax returns, that the taxpayer deducted in its returns for the years for which the scrip was issued the interest represented by the scrip. While the debt of the taxpayer in the purchase of this scrip at the discount stated is not strictly a cancellation of the indebtedness, considering it to be a part of the plan of reorganization of the taxpayer in a bankruptcy proceeding it is not believed any tax liability should be asserted with respect to this transaction unless the taxpayer has had the benefit in prior years of a reduction of its tax liability on account of deductions from gross income by reason of the accrual of the interest items for which the scrip was issued. With respect to any such amount, if the period of limitation on assessment of taxes has not expired for the years

for which such deductions were taken, the returns for such years will be readjusted. If the period of limitation on assessment for such years has expired such amounts, less cost of the scrip will be included in income for the year in which the purchase scrip occurs.

Respectfully,

(Sgd.) Guy T. Helvering
Commissioner."

IN THE
Supreme Court of the United States

OCTOBER TERM, 1944.

No. 28.

CLARIDGE APARTMENTS COMPANY, a corporation,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

REPLY BRIEF FOR PETITIONER.

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REPLY BRIEF FOR PETITIONER.

May it Please the Court:

On page 15 of his brief, respondent states:

"No. 28 involves the meaning and application of sections 268 and 270 of the Bankruptcy Act to undisputed facts. Such questions are clearly questions of statutory construction; nor can they be said to be peculiarly within the experience of the Tax Court. We do not understand that the opinion in the *Dobson* case forecloses the circuit courts of appeal from reviewing decisions on such questions."

We do not contend that the "*Dobson* case forecloses the circuit courts of appeal from reviewing decisions on such

questions." Nor do we question that the statute confers on those courts the power to consider "the proper interpretation and application of the statute." We do not request any "narrowing of appellate jurisdiction". Nor do we question that a decision based on a plainly erroneous construction of a statute should be reversed.

We merely say, in the words of this court, as quoted on page 15 of our main brief:

"But where the question is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially, the reviewing court's function is limited. Like the commissioner's determination under the Longshoremen's & Harbor Workers' Act, that a man is not a 'member of a crew' (*South Chicago Coal & Dock Co. v. Bassett*, 309 U. S. 251, 84 L. ed. 732, 60 S. Ct. 544) or that he was injured 'in the course of employment' (*Parker v. Motor Boat Sales*, 314 U. S. 244, 86 L. ed. 184, 62 S. Ct. 221) and the Federal Communications Commission's determination that one company is under the 'control' of another (*Rochester Teleph. Corp. v. United States*, 307 U. S. 125, 83 L. ed. 1147, 59 S. Ct. 754), the Board's determination that specific persons are 'employees' under this Act is to be accepted if it has 'warrant in the record' and a reasonable basis in law."

Whether, on undisputed facts, debt is "canceled or reduced" is not one whit different than whether, on undisputed facts, one corporation is under the "control" of another or whether one person is an "employee" of another or was a "member of a crew" or was injured in "the course of the employment" or was "a producer of coal".

We call this court's attention to the argument of the government at pages 46 to 52 of its brief in *National Labor Relations Board v. Hearst Publications*, 332 U. S. 111, which is the same argument we make here and which the court adopted in that case.

In the *Dobson* case this court said:

"However, all that we have said of the finality of administrative determination in other fields is applicable to determinations of the Tax Court."

Also the Tax Court is especially competent to decide whether debt was canceled, especially in view of the relation of the question to the income and basis provisions of the Revenue Act and its knowledge of reasons sections 268 and 270 were enacted and of the background of the situation which brought them into existence.

It should be noted that in the case at bar there is no conflict on this question between determinations of administrative agencies, i.e. the Commissioner and the Tax Court, because, as pointed out on page 4 of our main brief, the Commissioner did not determine the deficiency by applying Section 270 to this case and did not decide that it was applicable. Moreover, even in cases where there is such conflict, the practical background of tax administration, in the absence of a regulation (see *Biddle v. Commissioner*, 302 U. S. at p. 582) entitles the Commissioner's determination to very little, if any, weight for with the decentralization now in effect in the revenue service, the determinations of "the Commissioner" are not made by him or even by his Washington office but by hundreds of Revenue Agents scattered throughout the country. (See 56 Harvard Law Review, page 1001). They issue the notices of deficiency.

While the personnel of the Tax Court and our great Commissions is of the first quality and entitled to great respect, no one who has ever had any practical experience with these Revenue Agents would attach any great weight to their conclusions. A *prima facie* presumption in their favor, which gives way when evidence is introduced to the contrary, is all the weight that can be afforded them.

We quote the words of the government's brief in this court in the case of *National Labor Relations Board v.*

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Hearst Publications, 322 U. S. 111, at pages 49 and 50, in support of our argument the Tax Court's decision cannot be reversed unless its application and construction of the statute is not a rational one.

"This does not mean that the conclusions of an administrative body are final either on a 'fact' or a 'law' question. The determination of the administrative body must have 'warrant in the record' (*Rochester Telephone Corp. v. United States*, 307 U. S. 125, 146) and a reasonable basis in the law. Just as an administrative decision which is unsupported by substantial evidence has no rational basis in fact, so, too, an administrative ruling which is plainly unreasonable in the light of express statutory language or other convincing evidence of legislative intention has no foundation in law. For either vice administrative action may be set aside. But 'the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body.' *Rochester Telephone Corp. v. United States*, 307 U. S. 125, 146.

"We believe that the scope of review which the court held applicable, in *Gray v. Powell* to the administrative determination that the railway was a 'producer' under the Bituminous Coal Act of 1937 is a proper one here. With respect to that determination the Court said that 'the function of review placed upon the courts . . . is fully performed when they determine that there has been a fair hearing, with notice and an opportunity to present the circumstances and arguments to the decisive body, and an application of the statute in a just and reasonable manner' (314 U. S. at 411). If there has been a 'sensible exercise of judgment,' the administrative decision must be left undisturbed. (*Id.*, at 413.)"

On page 21 of our main brief it is stated the capacity of the Tax Court is about 1158 decisions a year. This is error. This was the number of cases heard last year, not decided. The Secretary of The Tax Court advises there were 662 opinions in cases heard for the fiscal year ended June 30, 1944. Of these cases, 445 were appealed. He also advises

that he has a record of appeals decided by the Circuit Court of Appeals, which shows that for the fiscal year ended June 30, 1944, 148 cases were affirmed, 73 were reversed and 16 modified. In other words, over two-thirds of the cases decided were appealed and, of those appealed, the Tax Court's decision was upset, in whole or in part, in about 40% thereof. This court cannot close its eyes to this condition and its effects on the business of the nation, on the revenue, on the general judicial administration of justice and where it will end, if it continues accelerated by the avalanche of tax cases, high war rates and unequalled prosperity will spawn. (U. S. Law Week, at page 3418, states this court rendered 138 majority opinions at the last term.) There is a decided limit to the capacity of the courts to decide cases.

Also, consider how long; even at present, a case drags on. The petition was filed April 11, 1941 (R. 3). The case was not reached for trial until February 25, 1942 (R. 1). It was not decided until December 4, 1942 (R. 2). A year later the Court of Appeals decided it (R. 228). Look at the records here in other cases.

Under the present attitude of Courts of Appeal, the Tax Court, in two-thirds of its decisions, is a mere fact finding agency to certify facts to the Circuit Courts of Appeal for determination of the law. Only this court can call a halt to this and, it is submitted, the case at bar calls for doing it.

REPLY TO ARGUMENT ON THE MERITS.

As to the comment at the bottom of page 23 of the government's brief, the bankruptcy reorganization was "a mere change in the form of ownership", so far as the bondholders were concerned. It was not final so far as the outcome of their investment was concerned.

As to the comment about "a double deduction" on page 24, there was none here because it is admitted a nontaxable reorganization took place.

Also no income arose to the bondholders who for \$277,000.00 bonds took over assets worth \$141,000. On page 43 of his brief respondent concedes they sustained a loss. They could not deduct it because of the reorganization provisions. The stockholders equity to which they succeeded was worth below zero. The new corporation had no income because the assets were the subscription price of its stock. For the regulation which so provides and decision in accord therewith see Capento Securities Co., 47 B. T. A. at p. 695. Regulation also quoted in 140 F. (2d) at p. 386, affirming that case. Cf. *Helvering v. Cement Investors*, 316 U. S. 527. The old corporation also realized no income unless a mortgagee realizes income when the mortgagor forecloses and takes his home. Even on the theory that an insolvent debtor realizes income if it becomes solvent by the transaction (see Capento Securities case 140 F. (2d) 382, Note 1) there was no income here because the insolvent lost all its property and did not have anything left to discharge its interest obligation. (In the American Dental case this court declared this distinction was without substance.) At the hearings on the sections 268 and 270 treasury counsel Kent told the Senate Judiciary Committee: "If the performance of the agreement involves the liquidation of all his assets, so that he has nothing left when the agreement is performed there is no tax question involved." He said it was otherwise if the debtor was left with free assets. (See p. 138, Senate Hearings on H. R. 8046, 75th Cong., 2nd session.)

On page 29 of his brief, respondent attempts to brush aside the Capento case but he cannot brush aside its reasoning which clearly demonstrates there was no income under the Kirby case in the case at bar. We ask the court to read both the Tax Court's and Appeal's court opinions in the Capento case. Also the legislative history shows sections 268 and 270 were addressed to situations within the supposed scope of the Kirby case and the Tax Court's opinion in the case at bar so states. The situation at bar produced no income under the Kirby case and hence there

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was no need for legislation addressed to such situations.

The respondent's letter, contained at page 59 of our main brief, and written within five weeks of the enactment of sections 268 and 270 shows he held no debt was "canceled" in cases such as that at bar. If the Treasury opinion was this Congress probably would and did think the same. This letter was written after the hearings on sections 268 and 270.

We do not agree with the statement on page 24 that the continuation of the basis provisions in bankruptcy would be outside the scope of the purpose of the reorganization provisions. They cut both ways and were intended to prevent basis being stepped down as well as up. Furthermore, Congress, to guard against future effects of a decision in the government's favor in this case, expressly provided in the 1943 Act that the old basis carry over in bankruptcy after 1942. (See government's response to petition for certiorari, herein.)

As to the argument on pages 26 and 27 (also pages 37 to 39) that Congress rejected in 1940 an amendment to provide the basis should be reduced by the amount of income freed from tax by section 268 and this shows the 1938 law was not to be so construed we submit that the hearings show nearly all thought this was the intent and purpose of the existing statute and Congress would have so clarified it but many complained such an amendment would not save them because, in some cases, so many millions of debt was reduced that, if such reduction was income excluded from tax by section 268,¹ they would have a zero basis unless

¹ Testimony of Adams, Hearings on H. R. 9864, 52 to 55, at p. 54 (See also testimony of Edmund Burke, pgs. 13, 14. See also pages 18 to 20.)

"The Congressman's suggestion is that 270 have added to it words to this effect: That the basis shall be reduced to the extent that the corporation is exempted from taxation under sec. 268. The difficulty, I understand, in that type of amendment is that no one knows to what extent the corporation is exempted under sec. 268 and it becomes very difficult to determine."

Congress provided the reduction should not go beyond the fair market value of the property. Congress, apparently, assumed the construction of existing law was as we contend but adopted the 1940 amendment to take care of such cases and afford them this needed relief.

The letter of Chairman Frank, of the Securities and Exchange Commission, contained in the House hearings at page 14, shows the uncertainty created by the *Kirby* case had brought reorganizations to a standstill and recites the millions by which debt was reduced therein. See list of reductions up to March 17, 1940 at pages 26, 29 and 30 of House hearings.

The sole purpose of section 270 is crystal clear. The Committee report, quoted on page 33 of our main brief, states it in these words:

"This provision is intended to prevent a double deduction."

In the case at bar, there was no possibility of a double deduction. Although respondent, at page 34 of his brief, is not prepared to concede no income arises out of a bankruptcy readjustment, yet he cannot and does not deny that, if any income did arise when the plan was approved in 1935 or when the final decree was entered in 1937, such income was freed from tax by other provisions of law (See page 34 of our main brief) and not by section 268, enacted in 1938. Hence, it cannot be denied this case is not within the sole purpose and intent of section 270. The Tax Court pointed out it was to free corporations from the *Kirby* cases. Also no income arose here.

Under respondent's construction of section 270, it logically follows that where debt is paid, even in cash, it is thereby canceled but, in note 18 on page 27, he admits he takes "no such extreme position". Yet, it logically follows from his construction of the statute. See 41 Col. Law Review p. 73. Hence he admits the statute cannot be read literally.

On page 28 he states:

"The legal effect of the transaction, both under corporate law and under tax law, was that the indebtedness on the bonds was paid to the extent of the value of the stock, and the remainder of the debt—the difference between the value of the stock and the principal amount of the bonds—was canceled. To the extent of this difference the transaction constituted a plain case of reduction of indebtedness."

It is inescapable that, if any debt was paid, the debt was all paid by the stock issue and it seems to us also inescapable that, if any debt was "canceled", it was all "canceled". Also, it surely was not merely reduced because none of it was left. Furthermore, under the decision quoted from at the bottom of page 42 of our main brief and many more, the debt was not paid under tax law.

In the strict sense, we do not think it was paid in any view because no one can pay himself, and the creditors, who were the equitable owners of the property, merely changed their evidence of ownership. The reason they could deduct no loss was because the tax law regarded the transaction as not finally closed.

The attempt, at page 40 *et seq.*, to answer our argument Congress, in a tax law, would have no reason to discriminate against federal bankrupts in favor of state court insolvent reorganizations, falls of its own weight. First, it asserts Congress may not have known what it was doing (that cannot be said of this court in deciding the instant case) and, at pages 42 and 43, that it was reasonable for Congress to penalize bankrupts for the benefits of bankruptcy. That Congress had no such intention is indicated by the provision in the 1943 Revenue Act that bankrupts shall have the transferor's basis, which was inserted to relieve, for the future, against a possible adverse decision in this case, albeit Senator Barclay stated in his speech on the veto it might not be needed. Also the provisions of sections 268 and 270 were unquestionably intended as relief provisions.

In answer to the argument on page 43, we pointed out on page 34 of our main brief that the bondholders were not allowed to deduct any loss on this transaction and the hardship of the construction sought and its conversion of income tax to a capital levy is discussed at page 43 of our main brief and explained by example.

On page 49 respondent says the words "for future tax purposes" in the Committee report relate to the event. By this reasoning, if Congress provided "stock dividends shall be taxable for future tax purposes" it would relate to the event of the dividend and impose a retroactive tax. "Tax statutes look to the future and not to the past". *Colgate-Palmolive Peet Co. v. United States*, 320 U. S. 422, 424.

Nor can respondent take any comfort from the Committee report (quoted at page 33 of our main brief) because, according to its express language, there must have first been income from debt forgiveness and, second, it must have been exempt from tax by section 268. This fully supports our argument on this point.

At the bottom of page 50 and top of page 51 of his brief, respondent concedes there is some merit to our contention, raised in the petition for the writ and at pages 47 to 50 of our main brief, that the Chandler Act did not apply to proceedings under section 77B closed by final decree long before it was enacted and that "as a matter of statutory construction, it is a plausible argument." However, he questions our right to raise the contention in this court.

We concede that, if the Commissioner had determined section 270 was applicable to this case and we did not raise this point below, we could not do so here. However, as pointed out on page 4 of our main brief, the Commissioner did not determine that section 270 was applicable and taxpayer did not appeal to the Tax Court from any such determination.

It was an issue which necessitated factual evidence of the value of the property at the date of the order confirming the plan, which was different than the date on which value was determined in the notice of deficiency.

If the Commissioner had raised it by answer the burden of proof would have been on him under Tax Court rule 14. Certainly, he is in no better position because he only raised it orally at the hearing. On this issue he failed before the Tax Court. In these circumstances, taxpayer should be able to raise here, to sustain the Tax Court's decision, the point that these sections do not apply to proceedings closed when they were enacted. This is a pure issue of statutory construction and, when this court takes a case to decide a matter of general importance, it ought not to leave it open on the overoptimistic assumption that more light would be cast on it had it been discussed by the court below than is now cast thereon by the arguments in the present brief.

However if the court holds the debt was not "canceled" or that the case is not within the object and purpose of sections 268 and 270—"to prevent a double deduction"—then because the court below declared the questions of interest cancellation and cost of the property moot and did not decide them the case can be remanded for their decision. If this course is taken the question whether the Chandler Act applies to cases disposed of by final decree before its enactment need not be decided here since it will only apply to the interest. It can be considered below in event the court below affirms the Tax Court's conclusion on the interest.

CONCLUSION.

(1) The meaning of Section 270 became fixed at the date it was enacted, June 22, 1938. It is submitted no one then thought bonds were 'canceled or reduced' when stock was exchanged for them. The Senate Hearings were held in January and February, 1938. As pointed out the Treasury gave examples of debt cancellation and reduction, none of which embraced the case at bar. All were real examples of debt cancellation or reduction. (See Kent page 138 of hearings.)

Three months after these hearings the Commissioner specifically ruled debt was not canceled (see our main brief

pages 35, 36) when stock was exchanged for bonds. He did not change his mind until three years later. It is reasonable that what the Treasury thought after the 1938 hearings closed, Congress also thought.

(2) On page 35 of his brief respondent says:

"In the first place there is no warrant in the language of Section 270 for construing it as operative only to the extent that Section 268 has afforded in the particular case a relief not otherwise available."

As pointed out on page 8 hereof, respondent has in effect, admitted in Note 18 on page 27 of his brief, its literal reading as he reads it, would produce absurd results. In such case this court will "follow the purpose rather than the literal words." Also it cannot in such case, be read apart from its legislative history. With crystal clarity this shows the sole reason it was proposed by the Treasury was to avoid a double deduction and the Committee report states this was the sole reason it was adopted. No other reason is stated or suggested by its legislative history. The Tax Court held sections 268 and 270 were in pari materia and should be construed together (R. 196) and so did the court below. (R. 235.) The retroactivity argument at pages 47 to 51 of respondent's brief proceeds wholly on this theory.

The legislative history shows the relationship. Section 268 was the father of Section 270. Without 268 Section 270 would never have existed. If section 268 does not benefit a case then Section 270 was not intended to harm it. These sections were remedial not punitive. Just relief and not unjust oppression was their sole object. They should be so construed by this Court.

(3) Also this case calls for a determination whether the Tax Court is a mere fact finding agency to certify facts to the Circuit Courts of Appeal for decision or whether it is more than that. Pages 4 and 5 hereof show that up to this court's decision in the Dobson case that is all it was in over two thirds of the cases decided by it. The judicial system's ability to give prompt and speedy justice will be impaired

and the Nation's business will suffer and be forced by uncertainty to postpone important business transactions if this condition is not sharply checked. This case illustrates how far this condition has extended. The Tax Court, well knowing the theory and purpose of the depreciation allowance, the history and purpose of the reorganization provisions, the reason for the enactment of sections 268 and 270 and their legislative history writes its opinion against this background of experience and knowledge; which opinion touches all these points, and holds debt has not been canceled under the facts of this case. The Government appeals and the Court of Appeals declares the Statute is plain and the sixteen judges of the Tax Court do not know "the ordinary or literal meaning" of words and for alleged failure to know "the ordinary and literal meaning" of the word "canceled" its decision must be reversed. (R. 233) In this opinion the Circuit Court discloses it does not know the basis of depreciation but thinks it is the present value of property (R. 233-236), it fails to reveal that it knows anything about the legislative history of sections 268 and 270 and declares Congress was trying to eliminate "make believe water values" (R. 233, 236), it apparently fails to think of the reorganizations provisions of the revenue act and finally it thinks the debtor made a profit out of the transaction or if it did not, that it is somehow saving it from tax by its construction of the statute, which thought it expresses in these classical words: "We are relieving an insolvent debtor from an income tax on a profit which it did not make when its debts were reduced." (R. 236.) Surely Congress did not intend reversals to be made on such patently untenable grounds that the Judges of the Tax Court do not know the "ordinary and literal meaning" of common English words. If the knowledge of a nominee for that Court was so wanting, or even if it was doubtful if he knew the "ordinary and literal meaning" of English words in common use, he would be so plainly unfit the Senate would never confirm him. If administrative bodies are to be reversed on such obviously untenable grounds as that they do

not know the plain and ordinary meaning of a common English word; all respect for them will be lost, and an avalanche of appeals to overwhelm the courts encouraged.

All of which is respectfully submitted.

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Counsel for Petitioner.

Nos. 101-70 28-29

In the Supreme Court of the United States

OCTOBER TERM, 1943

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH
CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1943

Nos. 701, 702

CLARIDGE APARTMENTS COMPANY, AN ILLINOIS
CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH
CIRCUIT

MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court (R. 183-199) is reported in 1 T. C. 163. The opinion of the Circuit Court of Appeals (R. 228-237) has not yet been reported.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on December 1, 1943 (R. 237, 238). A petition for a rehearing was filed by the taxpayer and denied by the Circuit Court of Appeals on December 22, 1943 (R. 238). The petitions

for writs of certiorari were filed on February 15, 1944. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer was formed in 1935 pursuant to a plan of reorganization under Section 77B of the Bankruptcy Act, and acquired all of the assets of the debtor company. (The conclusion of the Tax Court that this acquisition was in connection with a "reorganization" within the meaning of the revenue laws, and hence entitled the taxpayer to use the old corporation's basis in computing depreciation, is not challenged here.) The old bondholders received stock in the new company having a market value substantially less than the face amount of the bonds.

The principal issues in this case are presented by the taxpayer's petition in No. 701:

1. Whether Section 270 of the Bankruptcy Act, as amended, is applicable to the tax years prior to 1938.

2. Whether there was a cancellation or reduction of indebtedness, within the meaning of Section 270 of the Bankruptcy Act, as amended, to the extent of the difference between the face amount of the bonds and the market value of the stock issued to the old bondholders.

The petition in No. 702 presents three subsidiary questions:

3. Whether the Tax Court erred in concluding that the basis should be reduced for the year 1938 to the extent of the accrued unpaid interest on the bonds under Section 270 of the Bankruptcy Act, as amended.

4. Whether the Tax Court's finding of the adjusted basis of the assets in the hands of the old corporation should be sustained.

5. Whether the Tax Court erred in sustaining the Commissioner's disallowance of certain deductions in 1937 on the ground that they were incurred and taken in 1936.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the appendix, *infra*, pp. 14-18.

STATEMENT

The taxpayer is a corporation organized on May 28, 1935, under the laws of the State of Illinois, pursuant to a proceeding under Section 77B of the Bankruptcy Act. It filed its income and excess profits tax returns for the years 1935 to 1938, inclusive, with the Collector of Internal Revenue for the First District of Illinois. (R. 184.)

In determining deficiencies for these tax years, the Commissioner reduced the depreciation allowances claimed by the taxpayer (R. 9, 12, 15-16, 18-19), and disallowed certain deductions claimed for painting, decorating and repairs in the year 1937, on the ground that these expenses were in-

curring during the year 1936 and were claimed in the taxpayer's 1936 return (R. 15). The findings of the Tax Court which are pertinent to the questions presented may be summarized as follows:

In 1924 the Claridge Building Corporation (herein called the Building Corporation) acquired a certain lot in Chicago from Charles F. Henry, pursuant to a contract whereby the Building Corporation agreed to issue and did issue its entire authorized capital stock to Charles F. Henry in consideration therefor. During the spring and summer of 1924, the Building Corporation caused an apartment building to be erected on the lot at a cost of \$385,326.37. By August 1, 1935, depreciation amounting to \$139,253.71 had been taken on a "cost" of \$424,609.19 which included a contractor's commission to Charles F. Henry. (R. 184.)

On March 25, 1924, the Building Corporation issued its 6 $\frac{1}{2}$ -percent first mortgage bonds in the principal amount of \$340,000. By October 1, 1931, the bonds were outstanding and unpaid in the principal amount of \$277,000. Defaults having occurred both in principal and interest, the trustee filed a bill of foreclosure on October 1, 1931, and all of the bonds were declared immediately due and payable. A decree of foreclosure was entered on February 19, 1932, but there was no sale of the mortgaged property under the decree and

the foreclosure proceeding was never consummated. The trustee took possession of the property and collected the rents after October 1, 1931. (R. 184.)

On June 16, 1934, the Building Corporation filed a voluntary petition in the District Court of the United States for the Northern District of Illinois, Eastern Division, under Section 77B of the Bankruptcy Act as amended (R. 185).

On November 27, 1934, the bondholders' committee, the Building Corporation, and one Minnie H. Case agreed on a reorganization plan. The plan provided for the formation of a new corporation to acquire the property. The new corporation would have an authorized capital stock of 3,080 shares. Ninety percent of the outstanding stock, or 2,770 shares, would be held by trustees, and the trust certificates would be issued to the bondholders on the basis of one share of stock for each \$100 face amount of bonds. Ten percent of the stock would go to the old stockholders. (R. 185.) This plan was confirmed and approved by the court by an order dated May 14, 1935. The order stated that the bonds and interest coupons were satisfied and of no further force and effect and authorized the issuance of the new securities. (R. 187.).

The taxpayer was organized pursuant to the plan and the property transferred to it (R. 188). Under the plan the taxpayer's stock was issued

at the rate of one share per \$100 face value of the bonds of the old company. The fair market value of the stock never exceeded \$45 per share at any time during the year 1935. Of taxpayer's 3,080 shares of common no par value stock, 2,770 shares were issued to nondepositing bondholders and to trustees for the depositing bondholders, 308 shares to old stockholders, and 2 shares remained unissued. (R. 189.)

The final decree in the Section 77B proceeding entered March 1, 1937, declared the first mortgage bonds in the principal amount of \$277,000 and interest coupons attached and the trust deed and chattel mortgage which secured them, to be of no further force and effect as against the debtor and its property, and that the holders thereof should be entitled to receive only the new securities provided for in the plan of reorganization (R. 187).

The property in question, including the building and furnishings and the lot on which it was situated, was sold in July 1940, for \$126,200, plus an assumption of about \$20,000 of liabilities. The market in 1940 was much higher and more active than in 1935. The fair market value of the building, exclusive of the land, as of May 14, 1935 (the date on which the court confirmed the plan), was not in excess of \$141,000. The fair market value of the land on that date was \$16,000. (R. 190.)

The adjusted basis of the taxpayer's predecessor in 1935 was \$239,377.33. At the date of the tax-

payer's acquisition of the property the building had a remaining useful life of 25 years. (R. 190.)

The taxpayer reported its income and deductions on an accrual system of accounting and under this system deducted all expenses for painting, decorating and repairs in the year in which such expenses were paid. In 1936 it included in its expense deductions an amount of \$1,219.44 for painting and decorating and \$389.60 for repairs expended in that year. These identical items were deducted for a second time in the taxpayer's 1937 return. (R. 190.)

The Commissioner contended that the taxpayer's basis for depreciation of its property was its market value on acquisition in 1935, but the Tax Court concluded (R. 191-194) that the taxpayer had acquired the assets in connection with a reorganization within the definition of Section 112 (g) of the Revenue Act of 1936, as amended, and that therefore its basis for depreciation was the adjusted basis in the hands of the predecessor company (R. 191-193). This conclusion was not challenged on appeal, and is not questioned here.

The Tax Court then considered the Commissioner's alternative contention that in the proceedings under Section 77B the debtor corporation's indebtedness had been "cancelled or reduced" to the extent of the difference between the liability on the bonds and the market value of the stock issued to the bondholders, and that

therefore the basis had to be reduced to the extent of the reduction or cancellation (although not to an amount less than the fair market value of the property at confirmation of the plan) under the provisions of Section 270 of the Bankruptcy Act. It held (R. 195-198): (1) that Section 270 did not apply to the tax years prior to the year 1938; (2) that upon issuance of the stock for the bonds, the indebtedness had not been "cancelled or reduced"; (3) that the accrued and unpaid interest on the bonds was cancelled, and that the cancelled interest could not be excluded from the write-down as "not resulting in a tax benefit on any income tax return"; (4) that the original cost of the building was \$385,326.37, as determined by the Commissioner; and (5) that taxpayer was seeking a deduction for 1937 which had already been taken and allowed for a prior year.

Both the Commissioner and the taxpayer appealed to the Circuit Court of Appeals for the Seventh Circuit, the Commissioner questioning the correctness of rulings (1) and (2), and the taxpayer challenging (3), (4), and (5). The court below sustained the Commissioner's contentions with respect to all of these issues (R. 236-237).

ARGUMENT

The principal contention made by the petitioner in these cases relates to the applicability of Section 270 of the Bankruptcy Act, as amended by the Act of June 22, 1938, to tax years prior to 1938.

That section provides for the reduction of the basis of property acquired in reorganization proceedings under the Bankruptcy Act, where the old basis carries over, to the extent that a corporate debt is canceled or reduced in such proceedings.¹

Section 276c (3) of that Act (Appendix, *infra*, p. 16)² provides that—

sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date, * * *

The taxpayer's plan of reorganization was confirmed and approved by an order of the court on May 14, 1935. The taxable years in question are 1935, 1936, 1937, and 1938. The Tax Court held that notwithstanding Section 276c (3), Section 270 applies only to 1938, the year in which the amendment was passed.

The court below reversed, holding that apart from the inferences to be drawn from the relation of Sections 268 (Appendix, *infra*, p. 14)² and

A further amendment of July 1, 1940 (Appendix, *infra*, p. 15), placed a floor beneath the reduction, by providing that in no case shall the basis be reduced below the fair market value of the property on the date of the order confirming the plan.

Section 268 relieves the debtor corporation of tax on any income or profit represented by an adjustment of indebtedness in a reorganization proceeding under Section 77B of the Bankruptcy Act, as amended.

270, the language of Section 276c (3) compels the conclusion that Section 270 applies in this case to the years 1935, 1936, and 1937, as well as to the year 1938.

While we believe the decision below is correct, it is clearly in conflict with *Commissioner v. Commodore, Inc.*, 135 F. 2d 89, in which the Circuit Court of Appeals for the Sixth Circuit sustained the ruling of the Tax Court that Section 270 does not apply to years prior to 1938. The importance of the question is diminished, however, by the fact that the records of the Bureau of Internal Revenue do not disclose any substantial number of cases involving this question. Moreover, as the result of a recent amendment to the Internal Revenue Code, the question of the effect and applicability of Section 270 in these situations may not arise in cases involving tax liability for years beginning on or after January 1, 1943.

The second question presented in No. 701 is whether there was a cancellation or reduction of the debtor's indebtedness, within the meaning of the Bankruptcy Act, when, pursuant to the plan of reorganization, shares of stock in the new corporation, worth less than the debtor's bond indebtedness, were issued to the old bondholders.

The court below reversed the Tax Court and sustained the Commissioner's contention that the

Section 121 (c) (3) and (e), Revenue Act of 1943, Public Law 235, 78th Cong., 2d Sess.

debtor's bond indebtedness was canceled or reduced to the extent of the difference between the face amount of the bonds and the market value of the stock issued. We believe that the Tax Court's conclusion rests upon a basic misconception of corporate law. It is apparently based upon the theory that the assets were not freed from obligation, for, although the bond loan had been terminated, the amount borrowed was committed to capital stock liability, by the issuance of stock, instead of to the liability of a fixed indebtedness. This reasoning necessarily assumes that the capital stock of a corporation is a liability, in disregard of the recognized principle that stock represents ownership, not debt. As stated by the court below, the words "cancelled or reduced" as used in the statute, are comprehensive and manifestly were intended to cover this type of situation. There was an elimination of the bond indebtedness which wiped out a direct debt liability, enforceable by legal action. As to this question, no conflict is asserted.

The analogue of this question, i. e., whether there was a cancellation or reduction of the principal of the indebtedness, is presented by the petition in No. 702, namely, whether there was a cancellation or reduction of the accrued unpaid interest which has resulted in a tax benefit to the petitioner on

¹ The same question is now pending before the Circuit Court of Appeals for the Sixth Circuit in *Commissioner v. Alcazar Hotel, Inc.*, No. 9678.

any income tax return. The Tax Court found that, even though there had been no cancellation or reduction of the principal indebtedness, accrued unpaid interest had been cancelled. However, in view of its conclusion that Section 270 applied only to the year 1938, no reduction of basis on account of the interest cancelled was allowed as to the prior tax years.

If, by reason of the conflict in the decisions as to whether Section 270 applies to years prior to 1938, this Court should determine to grant certiorari in order to resolve such conflict, it would seem appropriate that the review should also include the related questions as to the cancellation or reduction of the principal debt and the accrued unpaid interest. Any holding by the Court on the question of the retroactivity of Section 270 obviously would affect the determination of these questions.

However, the two remaining questions presented in No. 702—whether the Tax Court's finding of the adjusted basis of the assets in the hands of the old corporation should be affirmed, and whether the Tax Court erred in sustaining the Commissioner's disallowance of certain deductions in 1937 on the ground that they were incurred and taken in 1936—are unrelated to the retroactivity question, and do not warrant further review by this Court. They plainly involve only issues of fact, and the findings of the Tax Court were correctly sustained.

by the court below as supported by the evidence. *Dobson v. Commissioner*, Nos. 44-47 this Term, decided December 20, 1943, rehearing denied February 14, 1944.

CONCLUSION

While the decision below is correct, it is clearly in conflict with a ruling of the Circuit Court of Appeals for the Sixth Circuit with respect to the retroactivity of Section 270 of the Bankruptcy Act, as amended. However, the importance of this question is not clear. If certiorari should be granted in order to resolve such conflict, we believe that the review should extend only to the determination of other questions which would be affected by the decision on the retroactivity question, i. e., whether there was a cancellation or reduction of the principal indebtedness and the accrued unpaid interest.

Respectfully submitted.

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MARCH 1944.

APPENDIX

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancellation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter. (11 U. S. C., Sec. 668.)

SEC. 269. Where it appears that a plan has for one of its principal purposes the avoidance of taxes, objection to its confirmation may be made on that ground by the Secretary of the Treasury, or, in the case of a State, by the corresponding official or other person so authorized. Such objections shall be heard and determined by the judge, independently of other objections which may be made to the confirmation of the plan, and, if the judge shall be satisfied that such purpose exists, he shall refuse to confirm the plan. (11 U. S. C., Sec. 669.)

SEC. 270 [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section. (11 U. S. C., Sec. 670.)

SEC. 276. * * *

* * *
 c. the provisions of sections 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, shall continue in full force and effect with respect to

proceedings pending under those sections upon the effective date of this amendatory Act; except that—

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of the chapter shall apply in their entirety to such proceedings; and

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient. (11 U. S. C., Sec. 676.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934, as amended by T. D. 4871, 1938-2 Cum. Bull. 130, and T. D. 5003, 1940-2 Cum. Bull. 107, 108-109:

ART. 113 (b)-2. *Adjusted basis: Cancellation of indebtedness.*—In addition to the adjustments provided in section 113 (b) (1) and article 113 (b)-1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in

which there shall have been a cancellation or reduction of indebtedness in any proceeding under section 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B of the Bankruptcy Act of 1898, as amended.

For the purposes of this article—

(A) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(B) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(C) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return;

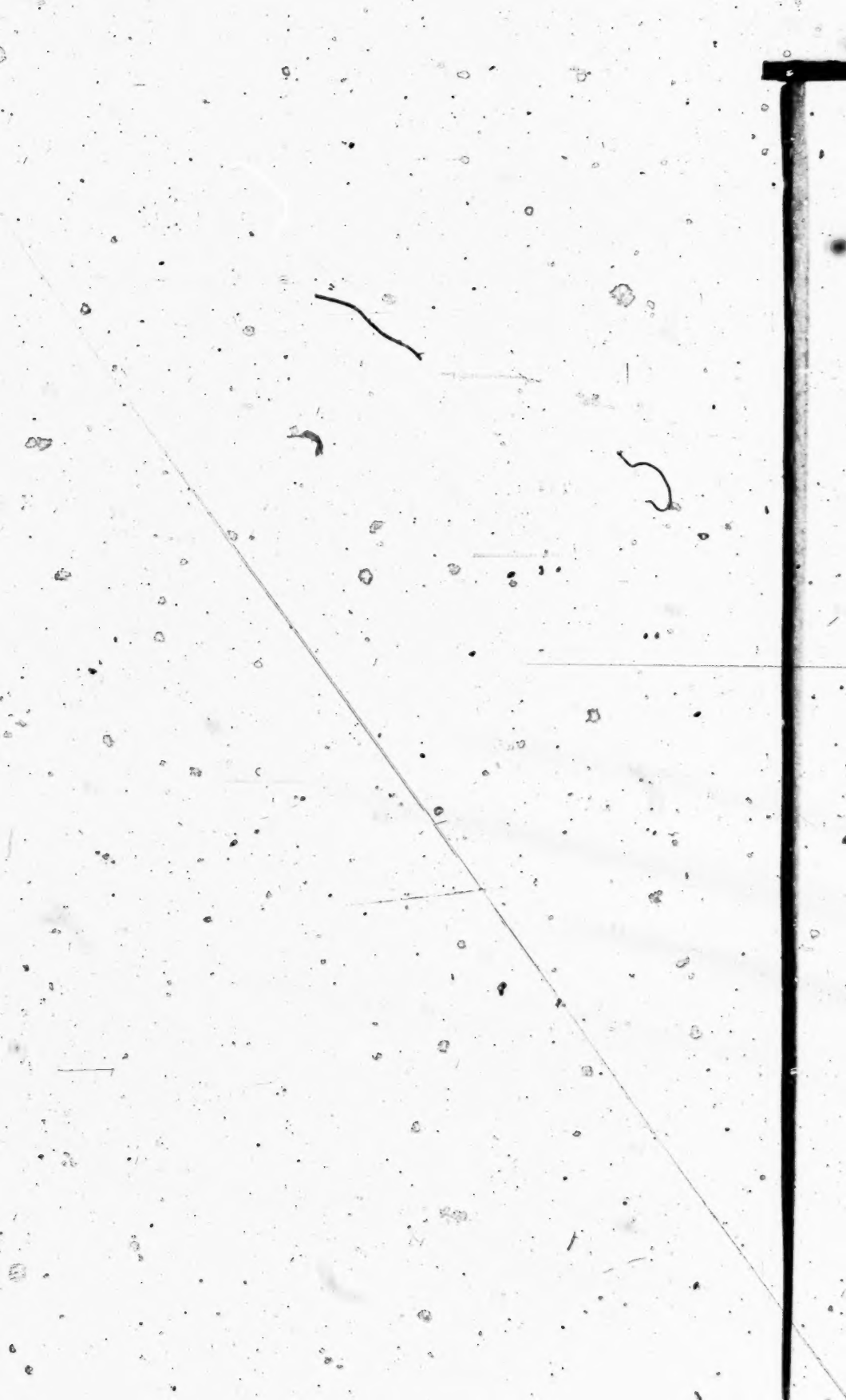
(D) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay; and

(E) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced.

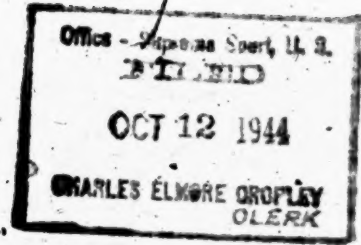
Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this article.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this article.

Article 113 (b)-2, Treasury Regulations 94, as amended by the same Treasury Decisions, is identical with the above-quoted article.



FILE COPY



Nos. 28, 29

In the Supreme Court of the United States

OCTOBER TERM, 1944

LARIDGE APARTMENTS COMPANY, AN ILLINOIS CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 183-199) is reported at 1 T. C. 163. The opinion of the circuit court of appeals (R. 228-237) is reported at 138 F. (2d) 962.

JURISDICTION

The judgments of the circuit court of appeals were entered on December 1, 1943 (R. 237-238). A petition for rehearing was denied on December 22, 1943 (R. 238). The petitions for writs of certiorari were filed on February 15, 1944, and were

granted on March 27, 1944. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer was formed in 1935 pursuant to a plan of reorganization under Section 77B of the Bankruptcy Act, and acquired all of the assets of the debtor company.¹ The old bondholders received stock of the taxpayer having a market value substantially less than the face amount of the bonds.

The principal questions, raised by the petition in No. 28, are:

1. Whether the issuance of taxpayer's stock to the debtor's bondholders resulted in a cancellation or reduction of indebtedness, within the meaning of Section 270 of the Bankruptcy Act, as amended (11 U. S. C. 670), to the extent of the difference between the face amount of the bonds and the market value of the stock issued in their place.

2. If a cancellation or reduction of indebtedness within the meaning of Section 270 is involved,

¹ In the Tax Court the Commissioner contended that the proceeding under Section 77B did not result in a "reorganization" within the meaning of the revenue laws, and that therefore the taxpayer was not entitled to use the debtor's basis in computing depreciation. The Tax Court held otherwise; and its conclusion in this respect was not questioned by the Commissioner in the circuit court of appeals, and is not challenged here.

whether that section is applicable to require a decrease in taxpayer's basis for the three tax years prior to 1938, the year in which the section was enacted.²

The subsidiary questions, raised by the petition in No. 29, are:

3. Whether the Tax Court erred in concluding that Section 270 required a decrease in taxpayer's basis for the year 1938 to the extent of the accrued unpaid interest on the bonds.

4. Whether the Tax Court's finding of the original cost of the assets should be sustained.³

5. Whether the court below erred in accepting the Tax Court's finding that the Commissioner

²The taxpayer contended below that the principle of non-retroactivity also precluded the application of Section 270 to the tax year 1938, or at least that portion of the tax year 1938 which preceded September 22nd, the date upon which Section 270 became effective. (See R. 195-196). Both courts below held the section applicable to the entire tax year 1938. The taxpayer's contention in this respect has now apparently been abandoned; the prayer of the petition in No. 28 is that the Tax Court's decision be "affirmed on the points of non retroactivity and non cancellation of debt." See also brief in No. 28, pp. 2-3. The contention is to be distinguished from the contention, now made by the taxpayer for the first time, that Section 270 is totally inapplicable because the reorganization proceedings were no longer "pending" when Section 270 became effective. This new contention is treated in Point II of our argument, pp. 50-53, *Infra*. See also footnote 32, *infra*.

³If this Court accepts, as did the circuit court of appeals, the contentions of the Commissioner on the two principal questions, this and the preceding subsidiary question will become academic, since, regardless of the accrued un-

had properly disallowed certain deductions in 1937 on the ground that they were incurred and taken in 1936.

STATUTES AND REGULATIONS INVOLVED

This case involves primarily the construction of Sections 268 and 270 of the Bankruptcy Act (Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Chandler Act; c. 575, 52 Stat. 840, and, as to Section 270, by c. 500, 54 Stat. 709; 11 U. S. C. 668, 670). These sections, together with certain related sections and the pertinent Treasury Regulations, are set forth in the Appendix, *infra*, pp. 63-72.

STATEMENT

The facts, as found by the Tax Court (R. 184-190), may be stated as follows:

The taxpayer is a corporation organized on May 28, 1935, under the laws of the State of Illinois, pursuant to a proceeding under Section 77B of the Bankruptcy Act. It filed its income and excess profits tax returns for the years 1935 to 1938, inclusive, with the Collector of Internal Revenue for the First District of Illinois. (R. 184.)

paid interest, the amount of the cancellation or reduction of principal indebtedness occasioned by the substitution of stock for bonds in the reorganization would be sufficient to decrease the original cost basis, computed on any proposed theory, to an amount substantially below the fair market value of the property.

In determining deficiencies for these tax years, the Commissioner reduced the depreciation allowances claimed by the taxpayer (R. 9, 12, 15-16, 18-19), and disallowed certain deductions claimed for painting, decorating and repairs in the year 1937, on the ground that these expenses were incurred during the year 1936 and were claimed in the taxpayer's 1936 return (R. 15).

In 1924 the Claridge Building Corporation, taxpayer's predecessor (herein called the Building Corporation), had acquired a certain lot in Chicago from Charles F. Henry, who in consideration therefor received the Building Corporation's entire authorized capital stock. During the spring and summer of 1924, the Building Corporation caused an apartment building to be erected on the lot at a cost of \$385,326.37. By August 1, 1935, depreciation amounting to \$139,253.71 had been taken on a "cost" of \$424,609.19, which included a contractor's commission to Charles F. Henry. (R. 184.)

On March 25, 1924, the Building Corporation issued its 6½ percent first mortgage bonds in the principal amount of \$340,000. By October 1, 1931, the bonds were outstanding and unpaid in the principal amount of \$277,000. Defaults having occurred both in principal and interest, the trustee filed a bill of foreclosure on October 1, 1931, and all of the bonds were declared immediately due and payable. A decree of foreclosure

was entered on February 19, 1932, but there was no sale of the mortgaged property under the decree and the foreclosure proceeding was never consummated. The trustee took possession of the property and collected the rents after October 1, 1931. (R. 184.)

On June 16, 1934, the Building Corporation filed a voluntary petition in the District Court of the United States for the Northern District of Illinois, Eastern Division, under Section 77B of the Bankruptcy Act as amended (R. 185).

On November 27, 1934, the bondholders' committee, the Building Corporation, and one Minnie H. Case agreed on a reorganization plan. The plan provided for the formation of a new corporation to acquire the property. The new corporation would have an authorized capital stock of 3,080 shares. Ninety percent of the outstanding stock, or 2,770 shares, would be held by trustees, and the trust certificates would be issued to the bondholders on the basis of one share of stock for each \$100 face amount of bonds. Ten percent of the stock would go to the old stockholders. (R. 185.) This plan was confirmed and approved by the court by an order dated May 14, 1935. The order stated that the bonds and interest coupons were satisfied and of no further force and effect, and authorized the issuance of the new securities. (R. 187.)

The taxpayer was organized pursuant to the plan and the property was transferred to it (R.

188). Under the plan the taxpayer's stock was issued at the rate of one share per \$100 face value of the bonds of the old company. The fair market value of the stock never exceeded \$45 per share at any time during the year 1935. Of taxpayer's 3,080 shares of common no par value stock, 2,770 shares were issued to nondepositing bondholders and to trustees for the depositing bondholders. 308 shares were issued to old stockholders, and 2 shares remained unissued. (R. 189.)

The final decree in the Section 77B proceeding entered on March 1, 1937, declared the first mortgage bonds in the principal amount of \$277,000 and interest coupons attached, and the trust deed and chattel mortgage which secured them, to be of no further force and effect as against the debtor or its property, and provided that the holders thereof should be entitled to receive only the new securities provided for in the plan of reorganization. (R. 187).

The property in question, including the building and furnishings and the lot on which it was situated, was sold in July 1940 for \$126,200, plus an assumption of about \$20,000 of liabilities. The market in 1940 was much higher and more active than in 1935. The fair market value of the building, exclusive of the land, as of May 14, 1935 (the date on which the court confirmed the plan), was not in excess of \$141,000. The fair market value of the land on that date was \$16,000. (R. 190.)

The adjusted basis of the taxpayer's predecessor in 1935 was \$239,377.33. At the date of the taxpayer's acquisition of the property the building had a remaining useful life of 25 years. (R. 190.)

The taxpayer reported its income and deductions on an accrual system of accounting and under this system deducted all expenses for painting, decorating and repairs in the year in which such expenses were paid. In 1936 it included in its expense deductions an amount of \$1,219.44 for painting and decorating and \$389.60 for repairs expended in that year. These identical items were deducted for a second time in the taxpayer's 1937 return. (R. 190.)

The Commissioner contended that the taxpayer's basis for depreciation of its property was its market value on acquisition in 1935, but the Tax Court concluded that the taxpayer had acquired the assets in connection with a reorganization within the definition of Section 112 (g) of the Revenue Act of 1934, as amended, and that therefore its basis for depreciation was the adjusted basis in the hands of the Building Corporation (R. 191-194). This conclusion was not challenged on appeal, and is not questioned here.

The Tax Court then considered the Commissioner's alternative contention that in the proceedings under Section 77B the Building Corporation's indebtedness had been "canceled or reduced" to the extent of the difference between the liabil-

ity on the bonds and the market value of the stock issued to the bondholders, and that therefore, under the provisions of Section 270 of the Bankruptcy Act, the basis had to be decreased by the amount of the reduction or cancellation (although not to an amount less than the fair market value of the property at confirmation of the plan). It held (R. 195-198): (1) that Section 270, having become effective on September 22, 1938, applied to the taxpayer's 1938 tax liability, but not to its liability for years prior to 1938; (2) that the issuance of the stock for the bonds was "not a cancellation or reduction of the liability represented by the bonds"; (3) that on the other hand the accrued and unpaid interest on the bonds was canceled, and that the interest so canceled could not be excluded from the write-down since the taxpayer had failed to establish it as "not resulting in a tax benefit on any income tax return"; (4) that the taxpayer was not entitled to include as part of the original cost of the building amounts allegedly paid by the Building Corporation for contractor's services, and that therefore the original cost of the building was \$385,326.38, as determined by the Commissioner; and (5) that the taxpayer was not entitled to claim as a deduction for 1937 expenses for painting, decorating and repairs which had already been taken and allowed as a deduction for a prior year.

Both the Commissioner and the taxpayer appealed to the Circuit Court of Appeals for the

Seventh Circuit, the Commissioner questioning the correctness of rulings (1) and (2), and the taxpayer challenging (3), (4), and (5). The court below sustained the Commissioner's contentions with respect to all of these issues (R. 237-238).

SUMMARY OF ARGUMENT

The issues involved in No. 28 (discussed in Points I and II below) are plainly issues of statutory construction, and not subject to the principles of finality applied to decisions of the Tax Court in *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231. They are accordingly treated in this brief as clear-cut questions of law which are for decision by the courts.

I

The court below correctly held that when the bondholders in a bankruptcy reorganization receive stock in a new company having a market value less than the face amount of their bonds, the indebtedness represented by the bonds is "canceled or reduced" as those words are used in Section 270 of the Bankruptcy Act, as amended. This follows from the normal meaning of the comprehensive language used in Section 270, and is reinforced by consideration of the legislative and historical background against which Section 270 was formulated. It cannot reasonably be supposed that Congress, without indicating any

such purpose, intended to exclude from the broad, general language of Section 270 the type of cancellation or reduction of indebtedness which is one of the commonest features of bankruptcy reorganizations. No satisfactory rationale for exclusion of this situation from the operation of Section 270 is suggested either in the opinion of the Tax Court or in the brief of the taxpayer.

The contention that Section 270 was intended to operate only where the cancellation or reduction had created income which would have been subject to tax unless relieved therefrom by Section 268 is inconsistent with the positive language of Section 270, and with its legislative history, including the legislative history of its retroactive amendment in 1940. So to interpret Section 270 would defeat the primary purpose of Section 268, which was to eliminate the need for determining in particular cases whether under existing laws and precedents a cancellation or reduction of indebtedness created taxable income. Moreover, strong representations were made to Congress in 1940 that Section 270 should be amended so as to express the interpretation urged by the taxpayer in this case; but these representations were unsuccessful, and the amendment actually adopted followed the contrary proposal by the Treasury Department. The 1940 amendment must therefore be taken as an unequivocal acceptance by Congress of the view that Section 270 does not

depend for its operation upon the effectiveness of Section 268 to free from tax.

II

The court below was also correct in holding that Section 270 is applicable to all open tax years of corporations reorganized under Section 77B of the Bankruptcy Act, including tax years prior to 1938, the year in which Section 270 was adopted. The intention of Congress to make both Sections 268 and 270 thus retroactive is clearly indicated by Section 276c.(3), which expressly provides that both sections "shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act". It is no answer to suggest that, under Section 276c.(3), Sections 268 and 270 are to be applicable to plans confirmed before 1938 but only in respect of 1938 and subsequent tax years. This suggestion neglects the fact that Section 268, which by its own terms operates *pari passu* with Section 270, can by its nature apply only to the tax year in which a plan of reorganization is confirmed. Congress can hardly have intended an accounting anomaly by virtue of which a tax benefit would be conferred in respect of a reorganization consummated in some year before 1938, while the correlative basis adjustment occasioned by the same reorganization would be required to be made only for 1938 and succeeding years.

The taxpayer here raises for the first time an alternative contention that Sections 268 and 270 are totally inapplicable to the case because the reorganization proceedings under Section 77B were no longer "pending" when the Chandler Act became effective. This contention, although plausible, neglects the fact that Sections 268 and 270 are essentially tax provisions. The contention would rest the incidence of tax consequences under these provisions upon a formality of reorganization procedure, rather than upon the substantive change of rights effected by the approval and consummation of a plan of reorganization.

That Congress could constitutionally provide retroactive application for Section 270 admits of little doubt, and is not seriously controverted here by the taxpayer.

III

Accrued unpaid interest on the Building Corporation's bonds in the amount of \$80,002.20 was forgiven in the reorganization, and it is conceded that this forgiveness amounted to a "cancellation" of indebtedness within the meaning of Section 270. In the state of the record, the Tax Court was clearly correct in holding that the taxpayer's basis should be reduced by the amount of this interest forgiveness (to the extent that such reduction would not decrease the basis below fair market value). Interest forgiveness is to be ex-

cluded from the amount of the write-down only when "not resulting in a tax benefit on any income tax return," and the taxpayer failed to make any showing which would qualify it for the benefit of this exemptive provision. In so far as the record might possibly have supported a factual inference as to the absence of any tax benefit, the refusal of the Tax Court to draw such an inference affords no ground for judicial review.

IV

The court below properly declined to disturb the findings of the Tax Court as to the original cost of the building and as to the propriety of certain small deductions claimed in 1937 for decorating expenses. In the view which the circuit court of appeals took of the application of Section 270 to the reduction of indebtedness by satisfaction of the bonds, the question as to the original cost of the building was correctly held to be academic. If, by reason of the decision of this Court on the main issues in the case, that question loses its academic character, the decision of the Tax Court should be affirmed under the principles of *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231. The same disposition should in any event be made of the item of decorating expenses. Both issues were purely factual in nature, and depended upon testimony which was either conflicting, or vague and

uncertain. The final determination of such issues lay peculiarly within the province of the Tax Court.

ARGUMENT

In the forepart of its brief in No. 28 (pp. 8-11, 13-28) the taxpayer strenuously contends that the Tax Court's decision in its favor on the issues involved in that case should have been affirmed on the theory that the principles announced by this Court in *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231, either apply or should be extended to apply thereto.

No. 28 involves the meaning and application of Sections 268 and 270 of the Bankruptcy Act to undisputed facts. Such questions are clearly questions of statutory construction; nor can they be said to be peculiarly within the experience of the Tax Court. We do not understand that the opinion in the *Dobson* case forecloses the circuit courts of appeals from reviewing decisions on such questions. The later opinion of this Court in *Security Mills Co. v. Commissioner*, 321 U. S. 281, is clear authority for a reversal of a decision of the Tax Court which is found to have proceeded upon an erroneous construction of a statute. The jurisdiction of the appellate courts to review decisions of the Tax Court springs directly from act of Congress; Section 1003 (b) of the Revenue Act of 1926 (c. 27, 44 Stat. 9; 26 U. S. C. 1141 (c) (1)) provides: "Upon such review, such

courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require." The committee reports on this section make plain the congressional intent as to the scope of appellate jurisdiction conferred; they expressly state that circuit courts of appeals "upon review may consider, for example, questions as to * * * the proper interpretation and application of the statute or any regulation having the force of law * * *" (H. Rep. No. 1, 69th Cong., 1st Sess., pp. 19-20; S. Rep. No. 52, 69th Cong., 1st Sess., p. 36).

The taxpayer's contention that the principles of the *Dobson* case should be extended to the questions involved in No. 28 thus ignores the command of Congress as to the appellate jurisdiction of the circuit courts of appeals. The requested narrowing of appellate jurisdiction is clearly a matter of legislative policy, and should not be undertaken by this Court. Accordingly, we proceed to discuss the issues of statutory construction presented in No. 28 as clear-cut questions of law which are for decision by the courts. See *Dobson v. Commissioner*, 320 U. S. 489, 492-493.

THE PROCEEDING UNDER SECTION 77B IN WHICH THE TAXPAYER ACQUIRED ITS PROPERTY RESULTED IN A CANCELLATION OR REDUCTION OF INDEBTEDNESS REQUIRING THAT THE BASIS OF TAXPAYER'S PROPERTY BE DECREASED TO MARKET VALUE UNDER SECTION 270 OF THE BANKRUPTCY ACT AS AMENDED

Apart from the question of retroactivity, with which we deal under Point II of this brief, the taxpayer's argument regarding the applicability of Section 270 appears to rest on three main propositions. These three propositions, as we understand them, are:

1. That when bondholders in a bankruptcy reorganization receive, for their bonds, stock in a new company having a market value less than the face amount of the old bonds, no "indebtedness * * * has been canceled or reduced" as those words are used in Section 270, and therefore Section 270 is by its own terms inapplicable.

2. That even if Section 270 is in its literal wording applicable to the transaction, it must be construed together with Section 268, relating to relief from taxation, and as so construed requires readjustment of the basis only in cases where the cancellation or reduction is of a character which in the absence of Section 268 would give rise to a taxable profit.

3. That under the general provisions of the revenue laws as interpreted by the courts the issuance of stock under such circumstances, even

if resulting in a cancellation or reduction of indebtedness, would give rise to no profit taxable as income, and that since Section 268 is therefore inoperative to afford relief from tax, Section 270 is likewise inoperative to require a compensatory adjustment of the basis.

We contest the soundness of each of these propositions. An understanding of our views with respect to each of them will, we believe, be served by considering at the outset the relationship of Sections 268 and 270 to each other and to the statutory scheme of which they are a part.

The revenue statutes have long contained so-called "reorganization"⁴ and "basis" provisions, designed in general to postpone the tax consequences of transactions regarded as "transitional, continuing transactions which are not sufficiently 'closed' to justify *economically* (though there may be a different answer on a strict *legal* basis) the imposition of capital gains tax at the immediate moment of an 'ordinary business' transaction."⁵ The first "reorganization" provision appeared in the Revenue Act of 1918.⁶ Readjustment of the

⁴ The term "reorganization," as used in tax law, has a quite different scope from the same term as used with reference to corporate readjustments under the Bankruptcy Act. In the interests of clarity the term is placed in quotation marks in this brief whenever it is intended to refer to the tax concept.

⁵ Paul, *Studies in Federal Taxation, Third Series*, pp. 4-5.

⁶ Revenue Act of 1918, c. 18, 40 Stat. 1057, Section 202 (b).

"basis" of property acquired in a "reorganization" was not at first required, but it was soon recognized that the omission enabled many taxpayers to secure unintended tax benefits by engaging in exchanges of property which, while themselves tax-free, resulted in an increased cost basis for purposes of gain or loss, depreciation, and the like.⁷ To remedy this "serious blunder", the first "basis" provision appeared in the Revenue Act of 1924.⁸ Each succeeding revenue act contained similar provisions, changes being made from time to time on account of discovered loopholes,⁹ or to afford additional relief.¹⁰ A general revision appeared in the Revenue Act of 1934, and the provisions of that act were retained without substantial modification throughout the period involved in this litigation.¹¹ The general purpose of the "reorganization" pro-

⁷ Paul, *op. cit.*, pp. 23-24.

⁸ Revenue Act of 1924, c. 234, 43 Stat. 253, Sections 204 (a) (6) and (7).

⁹ Paul, *op. cit.*, pp. 36-41.

¹⁰ E. g., Revenue Act of 1939, c. 247, 53 Stat. 862, Section 215.

¹¹ Sections 112 and 113 of the Revenue Acts of 1934 (c. 277, 48 Stat. 680), 1936 (c. 690, 49 Stat. 1648), 1938 (c. 289, 52 Stat. 447), and the Internal Revenue Code (26 U. S. C. 112, 113). The 1939 amendment referred to in the preceding footnote gave a measure of relief from tax liability upon the discharge of indebtedness. Section 121 (c) (3) of the Revenue Act of 1943, although changing the law prospectively with reference to corporations reorganized under the Bankruptcy Act, does not affect the tax years here in question. See footnote 29, *infra*.

visions is, in substance, to maintain free from immediate tax consequences what would otherwise be regarded as taxable gains and deductible losses; the "basis" provisions—requiring continued use of the transferor's basis in a tax-free "reorganization"—are designed to prevent the use of tax-free "reorganizations" as a means of securing stepped-up bases for depreciation and other purposes. The provisions complement each other; their general contemplation is that when the tax on an exchange is postponed through temporary nonrecognition, the taxpayer should by the same token be required to retain the original cost—to itself or to its predecessor, as the case may be—as a basis for future tax purposes. The provisions maintain the status quo with respect both to tax benefits and tax detriments.

This general pattern of "reorganization" and "basis" provisions under the 1934 Act was predicated on an assumption of continuity of interest in all parties, with a mere change in form of organization or form of indicia of ownership, insufficient in itself economically to justify either imposition of tax or readjustment of basis. The provisions apply to all exchanges falling within their terms; and when, in June, 1934, Section 77B of the Bankruptcy Act was adopted, the general "reorganization" and "basis" provisions of the revenue acts became equally applicable to reorganizations under that section, provided that they

met the test of what was a "reorganization" under the general standards of the revenue laws.

However, many reorganizations under Section 77B did not meet that test—or there was at least considerable doubt whether they did. It is a commonplace of bankruptcy reorganizations, predicated on insolvency, that the focus of interest shifts—that stockholders or junior creditors are reduced in interest or eliminated altogether, and the enterprise is handed over in whole or in greater part to the senior creditors. The case at bar is typical, the bondholders receiving a 90% interest in the stock of the new corporation and the old stockholders being reduced to a 10% participation. In many bankruptcy reorganizations the stockholders receive even less generous treatment. Moreover, a common phenomenon of bankruptcy reorganizations is the reduction of funded debt—since usually the need for reorganization is occasioned by excess of funded debt and other similar fixed charges. It was reasonable to suppose that such a reduction might under the doctrine of *United States v. Kirby Lumber Co.*, 284 U. S. 1, create income which in the light of *United States v. Hendler*, 303 U. S. 564, would be taxable as such at the time of the reorganization.

Sections 268 and 270 of the Chandler Act were formulated against this background. The Chandler Act was a general revision of the provisions for

bankruptcy reorganizations, designed in part to strengthen judicial and administrative controls in the interests of fair and equitable reorganization plans, and in part to encourage the use of the bankruptcy reorganization mechanism so as to avoid unnecessary or premature liquidation of business enterprises. As noted above, the "reorganization" and "basis" provisions of the general tax laws applied, no less than in other areas, to an exchange occurring in a bankruptcy reorganization, provided that it met the statutory standards. The difficulty, however, was to determine whether in a particular case these standards were met. A guess made in advance might well later be held wrong by the courts, with heavy tax consequences to the reorganized company. The uncertainty of the law in this respect was such as to discourage in many cases the use of the bankruptcy reorganization mechanism.

In Sections 268 and 270, therefore, Congress undertook to deal with but one restricted corner of the "reorganization" field—corporate reorganizations through the bankruptcy process. It further limited its attention to a single aspect of bankruptcy reorganizations, the aspect of debt reduction, which, while it might or might not involve an exchange subject to the general "reorganization" provisions, was an almost invariable concomitant of bankruptcy reorganization. Section

268 is narrowly confined in its operation. It does not purport to alter the principles governing exchanges generally, nor to affect the basis of individual security holders acquiring new securities in the reorganization. In effect it provides, in exclusive relation to the debtor, the trustee, and the succeeding company, that whatever might be held to be the consequences of a debt reduction under the general "reorganization" provisions of the tax law, such a reduction in a bankruptcy reorganization shall have no direct tax consequences. It shall result in no tax "under any law of the United States or of any State now in force or which may hereafter be enacted."

To the extent that Section 268, in its narrow field, relieves certain common incidents of bankruptcy reorganizations from tax consequences, it parallels the "reorganization" provisions of Section 112 of the Revenue Acts. However, at that point the parallel ceases. Section 268 of the Bankruptcy Act is not, like Section 112 of the Revenue Acts, predicated on an assumption of continuing, open transactions. A bankruptcy reorganization possesses characteristics of finality not common to the ordinary "reorganization" contemplated by Section 112, which is often enough no more than a "mere change in the form of ownership."¹² Consequently, when it appeared

¹² See Paul, *Studies in Federal Taxation, Third Series*, p. 5.

that the draft of the Chandler Act originally considered by the House Committee contained no equivalent of the present Section 270—thus leaving the general “basis” provisions unaffected—the Treasury officials were prompt to suggest to Congress that in bankruptcy reorganizations the type of remission of tax envisaged by Section 268 would be unfair to the revenue unless complemented by a requirement for decrease of basis equivalent to the amount of the reduction of indebtedness.¹³ Without such a requirement, a double deduction might result. Moreover, continued application of the general “basis” provisions to the typical bankruptcy reorganization whose principal feature was a reduction of indebtedness would be outside the scope of the purpose which originally motivated their adoption—the purpose of preventing the creation of a new stepped-up basis through the device of “reorganization.” “Reorganizations”

¹³ Hearings before House Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess., pp. 352-354; Hearings before Subcommittee of Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., pp. 137-139, 145-146. The original Treasury suggestion, proposed in the House (Hearings, pp. 353-354), was that the decrease in basis be measured by “the extent of the amount of the exclusion from gross income to which the debtor is entitled under the preceding paragraph [i. e., the then equivalent of the present Section 268].” This suggestion was not followed, however: Section 270, as later proposed by the Treasury to the Senate, and as finally adopted, measures the decrease in basis by the amount of the reduction of indebtedness, without regard to the extent of remission of tax. See footnote 24, *infra*.

in the nature of mergers, consolidations, or recapitalizations were easily susceptible of manipulation so as to create a new, higher basis; a bankruptcy reorganization bringing about a reduction of indebtedness, whether or not it was likewise technically a "reorganization," could rarely lead to the same result.

Section 270, thus, is in the nature of an amendment to the general "basis" provisions of Section 113 in so far as they apply to one narrow aspect of bankruptcy reorganizations. Like Section 268, Section 270 is not concerned with exchanges generally, nor with the basis of reorganization-acquired property in the hands of security holders. Its effect, as originally adopted, was to provide that in any case of a bankruptcy reorganization where the general "basis" provisions were applicable, so that the debtor, the trustee, or the transferee under the reorganization plan would be required to continue to use the debtor's original basis, that basis should nevertheless be reduced by the amount of any cancellation or reduction of indebtedness occurring in the reorganization.

Doubtless, as originally adopted, Section 270 fulfilled its purpose of protecting the revenue. But it was soon found that the draftsmen had made a mistake—that they had made the section much too stringent. Witnesses appearing before a special subcommittee of the House Judiciary Committee in 1940 pointed out that under the

section as enacted the amount of reduction of indebtedness might be so great as to reduce the basis in the hands of the transferee to a point substantially below its fair market value, to zero, or even to a point below zero.¹⁴ Two proposed solutions were discussed: (1) to provide for a decrease of basis "only to the extent to which taxable income would have been created by the reduction in indebtedness if such income had not been freed from taxation by section 268," and (2) to place a floor under the basis, preventing its decrease below fair market value at the time of reorganization.¹⁵ The suggestions were not alternative means of reaching the same result; though both sought amelioration in the interests of promoting the use of the bankruptcy reorganization mechanism, their precise objects and their tax consequences differed widely. The former suggestion, designed by its sponsors to bring the bankruptcy situation into line with the general "reorganization" and "basis" provisions of the revenue laws,¹⁶ was opposed by the Treasury De-

¹⁴ Hearings before a special subcommittee on bankruptcy and reorganization of the House Judiciary Committee on H.R. 9864, 76th Cong., 3d Sess.

¹⁵ See particularly Hearings, pp. 5-13, testimony of John Gerdes, chairman of the committee on reorganizations of the Commercial Law Section of the American Bar Association, and of the committee on bankruptcy and reorganization of the Association of the Bar of the City of New York.

¹⁶ See Hearings, pp. 6, 56-61.

partment and others¹⁷ as lacking in sufficient definiteness and certainty, and as producing undesirable tax results. This suggestion was accordingly rejected, and the section was amended retroactively to its present form, in which, while still requiring decrease of basis measured by the amount of reduction or cancellation of indebtedness, it provides that in no event shall the decrease be to a point "less than the fair market value of such property as of the date of entry of the order confirming the plan."¹⁸

Against this background, let us consider the several arguments of the taxpayer against the decision of the court below.

1. *The Section 77B reorganization in which the taxpayer acquired its property resulted in a cancellation or reduction of the Building Corporation's indebtedness to the extent of the difference between the face amount of the bonds and the market value of the stock received by the bond-*

¹⁷ See Hearings, pp. 6-7, 15-18, 56-61.

¹⁸ Dr. Gerdes in addition proposed a clarifying amendment designed to make clear that a cancellation or reduction of indebtedness should not be deemed to have taken place to the extent that the creditors received partial payment of their debts "in money, property, or shares of stock." See Hearings, p. 7. Otherwise, he pointed out, there was danger that Section 270 might be construed to require a decrease in basis even if cancellation of indebtedness had been accomplished through payment. The Treasury Department had taken no such extreme position in construction of the law, and the amendment was rejected, presumably as unnecessary.

holders.—The Building Corporation was obligated on its bonds in the principal amount of \$277,000. The reorganization under Section 77B extinguished that entire indebtedness upon the issuance to the bondholders of 2,770 shares of the taxpayer's stock, having a market value of only \$45 a share, or \$124,650 in the aggregate (R. 189). The legal effect of the transaction, both under corporate law and under tax law, was that the indebtedness on the bonds was paid to the extent of the value of the stock, and the remainder of the debt—the difference between the value of the stock and the principal amount of the bonds—was canceled. To the extent of this difference the transaction constituted a plain case of reduction of indebtedness.

The taxpayer argues, and the Tax Court decided (R. 197), that “there was here no true reduction or cancellation of the original indebtedness, but what amounts to a continuation of it in another form,” and that therefore neither the language of nor the reason for Section 270 of the Bankruptcy Act had any application to the case.¹⁹ The Tax Court followed its own earlier decision in *Capento Securities Corp. v. Commissioner*, 47

¹⁹ The statement quoted in the text from the opinion of the Tax Court somewhat undermines the force of the taxpayer's comment, at p. 41 of its brief in No. 28: “The statement of the court below that capital stock is not a debt is another straw man and false issue wholly immaterial to any question here presented. No one ever asserted it was a debt. The Tax Court was correct in terming it a liability.”

B. T. A. 691, since affirmed in 140 F. (2d) 382 (C. C. A. 1). The *Capento* case involved no bankruptcy reorganization, and no question of application of Section 270. A going concern, desiring a bank loan and being required by the bank to accord to the loan priority over its outstanding bonds, acceded to the suggestion of the bank that in order to facilitate the required priority the bonds, all of which were held by an affiliate, should be replaced by preferred stock having a par value equal to their face amount. The Board of Tax Appeals and the First Circuit Court of Appeals held that the Commissioner was in error in attempting in this situation to assess a deficiency in income tax against the issuing company measured by the difference between the face amount of the bonds and the market value of the preferred stock (which was substantially below its par value).

Whatever may be the correct tax result in a continuing transaction whereby, for mere purposes of corporate convenience and to facilitate the securing of a bank loan, a corporation changes the form of its outstanding securities held by an affiliate, we submit that the *Capento* case has no bearing on the problems involved in the case at bar.²⁰ Here, the Building Corporation entered

²⁰ In the *Capento* case the preferred stock had the same aggregate par value as the aggregate face amount of the bonds which it replaced. *Quaere*, whether the same result would have been reached if, as here, the stock had been without par value.

into a bankruptcy reorganization, motivated by the fact that it was and had long been unable to service its bonds, and that its property at current market values was worth substantially less than the face amount of the bonds. The substance of the reorganization plan was that the Building Corporation, being unable to pay its debts, turned the property over to its creditors in partial satisfaction thereof. To the extent of the value of the property thus turned over, the debt was paid in kind; to the extent of the difference, the debt was canceled.

Doubtless in technical accounting language common stock represents a balance sheet liability. But that is very different from concluding, as the Tax Court did (R. 197), that the substitution of stock for bonds represents merely a substitution of one form of debt for another. Common stock is not ordinarily thought of as representing a "debt" of its issuer, and its legal characteristics are totally dissimilar. As the court below held (R. 232):²¹

* * * The acceptance of the stock for the bonds wiped out a direct debt liability, enforceable by legal action. The debt carried an interest obligation and priority of rights. The stock carried no right to interest and not even to dividends, unless surplus existed, and a declaration of distribution had been made. It carried no right

²¹ Citing *Eyster v. Centennial Board of Finance*, 94 U. S. 500.

to collect the sum represented by the investment therein. At best it is a right only to a proportionate distribution of the assets over and above all debts of the corporation, in case of liquidation.

That stock does not represent a debt is indeed axiomatic. When a debtor, unable to meet its debts, enters into a composition with its creditors whereby the entire debt is released in consideration of the transfer of property having a value equal only to a portion of the debt, the debt is obviously paid to the extent of the value of the property transferred, and canceled as to the balance. When the evidences of ownership of the property so transferred take the form of stock, the result is the same. To the extent of the value of the stock, the debt is paid. The balance of the debt is canceled.

The literal language of Section 270 leaves, we submit, no scope for any other conclusion. The words "canceled or reduced," as used in the section, are comprehensive, and cover just such a case as this. When words may be given their usual and ordinary meaning without violation of the scheme of a statute, or the legislative purpose, the sound rule of construction is that they be given that meaning. *DeGanay v. Lederer*, 250 U. S. 376, 381; *Avery v. Commissioner*, 292 U. S. 210, 214. Here, the scheme of the statute and the manifest legislative purpose emphasize the propriety of giving to Section 270 a construction in accordance

with the usual and ordinary meaning of its words.

As already pointed out (*supra*, pp. 21-22), Congress in enacting Sections 268 and 270 sought to encourage bankruptcy reorganizations as a means of rehabilitating illiquid business enterprises. Common experience teaches that the most usual factor motivating a bankruptcy reorganization is an excess of fixed charges in the form of bonded indebtedness, and that the most usual means of reducing these fixed charges to a point at which they can successfully be borne by the enterprise is to cancel them, in whole or in part, and in compensation to turn the property over, in whole or in part, to the bondholders. The taxpayer itself asserted, as one of the reasons urged for granting the writ in No. 28, that the question "whether debt is 'canceled or reduced' in circumstances such as this exists in hundreds of 77B reorganizations" (Pet. in No. 28, p. 5). Accordingly, the instant case could hardly be excluded from the operation of Section 270 without substantially eviscerating the section. Certainly no such result should be reached without some convincing rationale of exclusion.

The taxpayer's proposed rationale of exclusion is far from convincing, and appears to us to be entirely without reasonable basis in the language or purpose of Section 270. According to the taxpayer (Br. in No. 28, pp. 39-40; see also Pet. in No. 28, p. 9), a debt is to be regarded as

"canceled" only when it is accorded no recognition in the plan, and as "reduced" when it is "recognized only in part." As a premise, this distinction is faulty, since Section 268 specifically mentions "cancelation in whole or in part of any of the indebtedness of the debtor." However that may be, on this premise the taxpayer attempts to distinguish between senior and junior debt, contending that if the value of the property exceeds the first mortgage but cannot meet the second mortgage in full, the second mortgage is "recognized only in part," and therefore "reduced" within the meaning of Section 270, whereas if the second mortgage is wiped out and the first mortgage bondholders receive all the property, "the full amount of the senior debt is recognized" regardless of the value of the property. We submit that the statute affords no warrant for a construction which would thus confine its operation to the settlement of the claims of junior creditors. Even were the distinction tenable logically, precise statutory language would be necessary to justify so great a restriction on the operation of a provision designed to establish a rule applicable to all indebtedness which is eliminated or reduced in a bankruptcy reorganization.

2. *The operation of Section 270 to require a decrease in basis measured by the amount of a cancellation or reduction of indebtedness is not dependent on the extent of relief granted in the*

particular case by Section 268.—The taxpayer contends that Section 270 is intended to require a decrease of basis only in cases in which Section 268 has operated to relieve from tax. On this assumption, the taxpayer argues that Section 270 is inapplicable here, either on the ground that the income, if any, created by the cancellation of indebtedness was already exempted by Section 112 (b) (4) of the Revenue Act of 1934, the general "reorganization" provision, and therefore needed and could secure no additional exemption from Section 268 of the Bankruptcy Act, or on the ground that the cancellation of indebtedness created no income of any kind which could have been subject to tax (Br. in No. 28, pp. 33-35, 41).

We are not prepared to concede the taxpayer's argument that a cancellation of indebtedness under circumstances of the type involved in this case creates no income which would be subject to tax. Admittedly, the law in respect of the taxable status of cancellation or forgiveness of indebtedness has long been in an uncertain state, but it seems entirely possible that the considerations delineated by this Court in the recent case of *Helvering v. Amer. Dental Co.*, 318 U. S. 322, might lead to the conclusion that the cancellation involved in this case produced income taxable as such under the doctrine of the *Kirby Lumber Company* case, 284 U. S. 1. However, we take no position on that issue here, in view of the patent unsoundness of

the petitioner's contention, that the operation of Section 270 is dependent upon the effectiveness of Section 268 to relieve from tax.

In the first place, there is no warrant in the language of Section 270 for construing it as operative only to the extent that Section 268 has afforded in the particular case a relief not otherwise available. The taxpayer would read the statute as if it required that the basis "shall be reduced by the amount of gain not recognized by Section 268." But the statute does not so require. It provides, without reference to Section 268, that the basis—

shall be decreased by an amount equal to the amount by which the indebtedness of the debtor * * * has been canceled or reduced in a proceeding under this chapter. * * *

Thus, though the event which sets in action the basis provision of Section 270 is the same event as occasions the application of Section 268, nothing in either section, or elsewhere in the Bankruptcy Act, makes the action of either dependent upon the operation of the other. Section 268, for instance, might relieve from a tax while Section 270 was in whole or in part inoperative because of the fact that the fair market value of the property was the same as or higher than the debtor's basis, or, as here, higher than the debtor's basis as decreased by the amount of the canceled debt. By the same token, Section 270 may require a de-

crease of basis even though the relief from tax contemplated by Section 268 was already afforded by some other provision of law. The mere fact of a complementary general purpose does not require complementary action as a condition of application in any given case.

That this is the correct view is shown by the consideration we have already given (*supra*, pp. 18-27) to the historical background and purposes of Sections 268 and 270. This Court has recognized the purpose of Congress in these sections to redeem at least the bankruptcy situation from judicial and administrative confusion regarding the application of income tax law to debt reductions. "The uncertainties of the effect of the remission of indebtedness on income tax brought about legislation to clarify the problems. The Chandler Bankruptcy Act of June 22, 1938, instituted adjustments deemed desirable." *Helvering v. Amer. Dental Co.*, 318 U. S. 322, 328. In 1938 the *Kirby Lumber Company* case, 284 U. S. 1, was already on the books, justifying the view, or at least the fear, that a reduction of bond liability might result in a tax to the debtor. *United States v. Hendler*, 303 U. S. 564, narrowing the scope of the general "reorganization" provisions in relation to discharge of bond indebtedness, had been decided in March of 1938. The decisions of this Court in 1942 elucidating the "continuity of interest" test applicable under the general "reorganization" provisions were as yet

unwritten.²² In this atmosphere of confusion Congress attempted to bring certainty at least to the bankruptcy reorganization field, by providing that, whatever might be the tax effect of a cancellation or reduction of indebtedness under the general "reorganization" provisions, such transactions should occasion no tax when effected in a bankruptcy reorganization. This laudable congressional effort at clarity would be substantially frustrated by the taxpayer's proposed construction. In every case it would still be necessary to determine what would have been the tax consequences of a given cancellation or reduction under the general "reorganization" provisions, since until such a determination had been made it would be impossible to decide whether Section 268 afforded relief not already available under some other provision of law. That task may by now have lost some of its difficulty; but the statute must be construed in the light of the problem confronting Congress in 1938.

Any doubt which might otherwise exist is resolved by the fact that the view urged by the taxpayer has already been heavily pressed upon Congress as grounds for amendment of the Act and

²² *Helvering v. Limestone Co.*, 315 U. S. 179; *Palm Springs Corp. v. Commissioner*, 315 U. S. 185; *Bondholders Committee v. Commissioner*, 315 U. S. 189; *Helvering v. Southwest Corp.*, 315 U. S. 194; *Helvering v. Cement Investors*, 316 U. S. 527. The "continuity of interest" test had been introduced in *Pinecliff Ice Co. v. Commissioner*, 287 U. S. 462, and elaborated in *Helvering v. Minnesota Tea Co.*, 296 U. S. 378, and *LeTulle v. Scofield*, 308 U. S. 415.

has been rejected. At the hearing on the amendment of Section 270 in 1940 (discussed at pp. 25-27, *supra*) it was contended that Congress, notwithstanding the language of the section, had intended to make its application dependent upon the effectiveness of Section 268 to relieve from tax. Witnesses at the hearing so testified, and sought to modify the proposed amendment so as to reestablish what they asserted was the original purpose.²³ The Treasury, abandoning its original position before the House Committee,²⁴ re-

²³ See testimony of Charles S. Banks, representing the National Bankruptcy Conference, and letter from former Representative Walter Chandler, who had sponsored the original Chandler Act, Hearings on H. R. 9864, 76th Cong., 3d Sess., pp. 56-61.

²⁴ As pointed out in footnote 13, *supra*, the original Treasury suggestion, made in the 1938 House hearings, had been that the decrease in basis be measured by "the extent of the amount of the exclusion from gross income to which the debtor is entitled under" Section 268. It was to this original suggestion that Mr. Kent, Assistant General Counsel of the Treasury, had directed the illustration which the taxpayer cites (Br. in No. 28, p. 32) as showing the Treasury intent. The bill reached the Senate without any equivalent of Section 270, and at the Senate hearings Mr. Kent furnished a similar illustration, together with other illustrations showing a somewhat broader objective. Hearings before Subcommittee of Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., pp. 137-139, 145-146. Discussions followed between Mr. Banks and the Treasury representatives, as a result of which the Treasury submitted a draft of Section 270 as it was finally adopted. The testimony of Mr. Banks in connection with the 1940 amendment (Hearings on H. R. 9864, pp. 59-60) shows clearly that by the time this final draft was submitted the Treasury Department had modified its earlier views as to the proper scope of a provision requiring reduction in basis.

sisted the suggested modification, and pressed for the "floor" provision, which was finally adopted and which both its supporters and opponents admitted would relieve some of the hardships created by Section 270 without, however, making its operation contingent upon relief under Section 268.²⁵ In the face of this legislative history of a retroactive amendment, the intention of Congress in the matter is hardly open to further question.²⁶

To summarize our construction, therefore, Section 270 is not confined in its application to those cases where Section 268 grants relief not otherwise accorded by the tax laws. The taxpayer's construction would effectively nullify the underlying objective of Section 268 to free all parties

²⁵ See testimony of Cordes, Hearings on H. R. 9864, pp. 6-13; Statement of John L. Sullivan, Acting Secretary of the Treasury, *id.*, pp. 15-18; testimony of Banks, *id.*, pp. 56-61.

²⁶ Section 22 of the Internal Revenue Code was amended by Section 215 of the Revenue Act of 1939 to afford generally to corporations "in an unsound financial condition" a limited measure of relief from income tax liability upon the discharge of indebtedness, comparable to the relief afforded by Section 268 of the Bankruptcy Act. On the reasoning of the taxpayer, presumably Section 270 of the Bankruptcy Act would be inapplicable in cases since 1939 where the relief afforded by Section 268 merely duplicated relief also available under the 1939 amendment to the Code. In other words, the 1939 amendment to the Code would serve further to narrow the scope of Section 270. Yet the legislative history of the 1939 amendment shows that it was not intended to affect cases under the Bankruptcy Act, H. Rep. No. 855, 76th Cong., 1st Sess., p. 5.

from the need of solving, for income tax purposes, the vexing questions whether a "reorganization" was involved, whether the cancellation or reduction created income, and whether if so it amounted to a tax-free exchange. Section 270 still requires determination whether a "reorganization" was involved, since only in such a case would the transferee be a "person required to use the debtor's basis";²⁷ but once that is established, the application of Section 270, like that of Section 268, is automatic. Determination of the existence of income, or of exemption under the general revenue laws, is dispensed with.

Against this construction of Section 270, which we believe impelled by its language and history, it may be argued that a Congress desiring to encourage use of the bankruptcy process for the rehabilitation of embarrassed business enterprises can hardly have intended to impose upon enterprises reorganized in bankruptcy a tax penalty, in the form of reduced basis, not incurred by enterprises reorganized through other means. It may be conceded that Section 270 is not a model

²⁷ See letter from Banks, representing the National Bankruptcy Conference, Hearings (Senate) on H. R. 8046, 75th Cong., 2d Sess., pp. 219-211: " * * * I accept the Treasury Department's viewpoint, that unless it is a case wherein the transferee is required under the revenue laws to use the debtor's basis, it would be best, in fact, necessary, to use cost to the transferee, thus accepting the Revenue Act and Treasury Regulations as the test of whether or not a reorganization under the Bankruptcy Act is a nontaxable reorganization."

of perfection, and that it did not, either originally, or as amended, in all respects achieve the aims of its framers. Deficiency in this respect is hardly a rare phenomenon in reorganization tax law, whether formulated through legislation, administration, or judicial interpretation. There is probably no field of law in which the process of trial and error has required more repeated revision of the legal framework in order to meet new conditions, or to remedy the unforeseen consequences of earlier pronouncements.²⁸ That Congress in 1938 may not have anticipated fully the consequences of its attempt to prevent a double deduction, which might otherwise have been available through the operation of Section 268 when coupled with the "basis" provisions of the Internal Revenue Code, is therefore an insufficient reason for unduly narrowing the scope of Section 270. Indeed, the retroactive amendment of Section 270 in 1940, providing that the basis should not in any event be reduced below the fair market value of the property, makes plain a congressional realization that in 1938 it had failed to envisage the full consequences of its original action.²⁹ Furthermore,

²⁸ See, generally, Paul, *Studies in Federal Taxation, Third Series, sub. cap. "Reorganizations,"* pp. 3-165.

²⁹ Cf. also the revision effected by Section 121 of the Revenue Act of 1943, Pub. L. 235, 78th Cong., 2d Sess. This amendment was prospective only, a fact which negatives the taxpayer's suggestion (Br. in No. 28, pp. 36-37) that the amendment in some way establishes a congressional intent in 1938 and 1940 inconsistent with the view we urge here.

the 1940 amendment serves to reduce materially the force of the criticism which prior to amendment was leveled at Section 270, as imposing a deterrent to bankruptcy reorganizations.³⁰ By virtue of the amendment the bondholders no longer risk taking over the property at a zero basis. While even under the amendment a decrease in basis may still be required which would not have been necessary had the same reduction of indebtedness been effected by reorganization outside of bankruptcy, it was surely not unreasonable for Congress to have regarded such a decrease as peculiarly appropriate in the special field of bankruptcy. For bankruptcy reorganization presents special benefits in the shape of opportunities to embarrassed business enterprises to tailor their

³⁰ See Darrell, *Discharge of Indebtedness and the Federal Income Tax*, (1940) 53 Harv. L. Rev. 977, 1009-1010; Surrey, *The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness*, (1940) 49 Yale L. J. 1153, 1186-1188; Warren and Sugarman, *Cancellation of Indebtedness and Its Tax Consequences: II*, (1941) 41 Columbia Law Rev. 61, 72-81; Paul, *Debt and Basis Reduction under the Chandler Act*, (1940) XV Tulane L. Rev. 1, 8-10. It may be noted that in the last mentioned article, much cited in the taxpayer's brief in No. 28, Mr. Paul, while recognizing "baffling problems arising out of Sections 268 and 270", comments that Section 270 literally "called for an automatic reduction of basis even though it constituted a contribution to the corporate capital, and even though for some other reason it was not recognizable income," and that the language of the section "seemed too plain to countenance deviations from a rigid general rule." *Op. cit.*, pp. 2, 6, 8.

structures and obligations to their actual business prospects, and to slough off permanently prior commitments which by the logic of events have proved incapable of fulfillment. Whatever might be the considerations applicable in other fields, it is entirely reasonable that in bankruptcy reorganization neither the debtor nor its proprietors (old or new) should be permitted to benefit from a cancellation or reduction of indebtedness unless that benefit should be reflected in future income through reduction of basis.

The old bondholders may, of course, complain that they have already had to sustain a loss in writing off the difference between the value of the property and the full amount of their claims; but, realistically viewed, that loss was not occasioned by the reorganization. By the time of commencement of reorganization their claims had an actual value to them no greater than the value of the property. When they take over the enterprise they take it over in sound financial shape, freed of obligations which had hampered the old proprietors and made successful operation impracticable. New proprietors who have received what thus amounts to an actual decrease in cost, or increase in net worth, have no sound ground for complaint that they are not permitted to duplicate their advantage by a continuation, for tax pur-

poses, of the original pre-reorganization cost of the property.³¹

II

SECTION 270 OF THE BANKRUPTCY ACT, AS AMENDED, IS APPLICABLE TO THE FOUR TAX YEARS IN QUESTION

The Tax Court held not only that the principal amount of the bonds was not "canceled or reduced" in the reorganization so as to bring Section 270 into play, but also that even as to the interest, which it agreed had been "canceled or reduced," Section 270 was inapplicable except in respect of the tax year 1938, the year in which the section was enacted.³² In so holding, the Tax Court followed its own earlier decision in *The*

³¹ It is incorrect to assume, as the taxpayer does, that Section 270 invariably works a hardship on bondholders who take over the property in satisfaction of their claims. Cf. the analysis of Gerdes, *Hearings on H. R. 9864* (footnote 14, *supra*), pp. 5-13, showing that the alternative proposal, equivalent to the taxpayer's proposed construction, could in certain financial situations work equal hardship. Congress was faced with the need of choosing between two proposed tax mechanisms, neither of which was considered entirely fair or satisfactory. Moreover, there was strong feeling in the congressional committee that, other things being equal, the nation's need in 1940 for protection of the revenue should be accorded paramount consideration. See *Hearings on H. R. 9864*, pp. 9, 22.

³² As indicated in footnote 2, *supra*, p. 3, the taxpayer has now apparently abandoned its contention, made below, that the principle of nonretroactivity precluded the application of Section 270 to the tax year 1938, or at least that portion of the tax year 1938 which preceded September 22nd, the date upon which the section became effective. We treat below, pp. 50-53, the new, alternative argument that Section 270 is

Commodore, Inc., 46 B. T. A. 718; and the decision of the court below in the instant case, extending the application of Section 270 to the tax years 1935-1937, is in square conflict with *Commissioner v. Commodore, Inc.*, 135 F. (2d) 89 (C. C. A. 6), in which the view of the Tax Court was upheld. We submit that the view of the court below, contrary to that of the Tax Court and the Sixth Circuit Court of Appeals, is correct.

It is of course true, as the court below recognized, that retroactive effect is not to be given to legislation unless the retroactive purpose "is expressly stated, or is to be inferred by clear intent, or by the necessary and unavoidable implications of the legislation." Here, both the language of the statute, and the necessary implications of the legislative policy which it was designed to effectuate, impel the conclusion that retroactive effect was intended to be given to it.

inapplicable to all the tax years in question because it applies only to plans of reorganization adopted in proceedings "pending" at the time it became effective. The taxpayer asserts, accurately (Br. in No. 28, p. 47), that the Tax Court "did not decide the question"; the reason for the Tax Court's failure, however, appears to be that the question was not presented to it. On the basis of the arguments which were presented to it, the Tax Court held specifically (R. 195) that the applicability of Section 270 to the tax year 1938 is "not subject to serious doubt."

R. 234, citing *Hassett v. Welch*, 303 U. S. 303; *United States v. Dakota-Montana Oil Co.*, 288 U. S. 459; Mertens, *Law of Fed. Income Taxation*, Sec. 3.33; *Brewster v. Gage*, 280 U. S. 327.

The statutory language is clear. The scope of application of Section 270 is specifically covered in Section 276.c, which provides:

(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B *before the effective date of this amendatory Act* and to any plan which may be confirmed under section 77B on and after such effective date. * * * [Italics supplied.]

In this case the plan was confirmed under Section 77B before the effective date of the Chandler Act, September 22, 1938. "Given their ordinary meaning," as the court below said (R. 235), the words of Section 276.c (3) leave no room for doubt that the plan was subject to Section 270.

The taxpayer contends, however, that in so deciding the court below "decided a false issue not in dispute and not an answer to this issue" (Br. in No. 28, p. 45). The taxpayer's contention, apparently, is that to concede the application of Section 270 to this plan is a very different thing from conceding that as so applied it requires readjustment of basis for tax years prior to the Act's effective date. According to the taxpayer, the Act says at most "that from the year of its enactment it applies in computing tax liability of 'any plan confirmed before the effective date of this amendatory Act'" (Br. in No. 28, pp. 45-46).

If this is the correct construction, the language of Congress is remarkably inept to convey its

meaning. Nothing would have been easier than to provide specifically that "on and after the effective date of this amendatory Act" Section 270 shall apply to plans earlier confirmed under Section 77B. The fact that Congress failed to follow so direct a path argues strongly that that was not the path it intended to follow. Congress was dealing not with tax consequences resultant from the enactment of the Chandler Act, but with the tax consequences of bankruptcy reorganization plans adopted under Section 77B. Section 276.e (3) by its terms is concerned with the application of Section 270 to "plans," not to tax years. The significant date in fixing the tax consequences of a plan is the date of the effectuation of the plan, not the date of effectiveness of the Chandler Act.

This conclusion, we submit, is reinforced by consideration of Section 270 in its context. As shown above, Sections 270 and 268 are complementary. Their interrelationship is recognized in the opening clause of Section 268 itself. Though Section 270 does not depend for its operation upon the actual granting of relief by Section 268 in the particular case, yet the two sections present facets of the same stone. The event—cancellation or reduction of indebtedness—which sets in motion the tax consequences of one brings the other also into play. It can hardly be doubted that if one is retroactive, so must the other be. Section 276.e (3) allows no distinction between them in this respect.

Yet it is clear that Section 268 is, and in its nature must be, retroactive. Section 268 covers the taxability of income created by the act of reorganization. The profit to which it refers, and which it excludes from tax, is a profit made at the moment of effectuation of the plan, and which if it were taxable at all would be taxable only as of that moment. The tax consequences, in terms of relief or benefit to the taxpayer, thus necessarily occur in the year when the plan takes effect; they can occur in no other.⁴ And orderly administra-

⁴ Accordingly, the Treasury Regulations under the Revenue Acts of 1934 and 1936 were retroactively amended in 1938 to provide specifically that no income should be deemed to have been realized in the case of a cancellation or reduction of indebtedness under a plan of corporate reorganization confirmed under Section 77B of the Bankruptcy Act. See Articles 22(a)-14 of Regulations 86 and 94, as amended by T. D. 4871, 1938-2 Cum. Bull. 130, 132-133, Appendix, pp. 65-68, *infra*. Articles 113(b) of Regulations 86 and 94 were likewise retroactively amended at the same time by the addition to each of a new Article 113(b)-2, dealing with the adjusted basis required by Section 270 in the case of a cancellation or reduction of indebtedness under Section 77B. *Id.*, pp. 133-135. Articles 113(b)-2 as thus added were retroactively amended in 1940 to reflect the 1940 "fair market value" amendment of Section 270. T. D. 5003, 1940-2 Cum. Bull. 107, 108-109; see Appendix pp. 68-72, *infra*. Tax benefits have thus been accorded both by Treasury Regulations and by Treasury practice under Section 268 for all open years preceding the adoption of Sections 268 and 270 in 1938, regardless of whether the reorganization was still pending when those sections became effective. The weight to be accorded to a Treasury Department interpretation thus formally expressed in a regulation and pursued in practice needs no citation of authority.

tion of the complementary features of Sections 268 and 270 plainly requires that the tax consequences in terms of reduction in basis should begin at the same time. It is, we submit, unreasonable to suppose that Congress, having made certain of relief from tax effective in the year of the reorganization, intended a windfall to taxpayers by permitting continued use of the transferor's basis for that year and all ensuing years down to 1938.

These are the considerations which we believe underlay the statement of the Senate Judiciary Committee from which the taxpayer here seeks to draw comfort.³⁵ It is true that the Senate Committee referred to reduction of basis "for future tax purposes." But the concept of futurity necessarily demands relation to a specific event. The taxpayer would identify that event as the coming of the Chandler Act into effectiveness, thus disregarding, for all years prior to 1938, the expressed intent of the Senate Committee "to prevent a double deduction." To avoid this unwelcome result, the event must, we submit, be identified as the event which created the danger of double deduction—the act of reorganization. When that event happens, then "for future tax purposes"—i. e., for tax purposes following that event—the basis must be reduced.

³⁵ S. Rep. No. 1916, 75th Cong., 3d Sess., p. 39. See Br. in No. 28, pp. 33, 46.

This natural reading of the Senate Committee Report comports with normal accounting practice. Indeed, it may be said as a general proposition that an adjustment of basis by reason of a given past event would instinctively be thought of as retroactive to the date of that event. Such an adjustment is designed, among other things, to create a continuing and equal effect upon the computation of depreciation in any and all years subsequent to the adjustment. To make the adjustment effective for only some of the years subsequent to the event which gave reason for the making of the adjustment would create an accounting anomaly; by changing the basis in mid-stream it would defeat the accounting objective of setting up a uniform depreciation over the entire period of estimated useful life. If, merely to avoid the charge of retroactivity, Congress had designed so irrational a result as a basis adjustment beginning with an event irrelevant to the need for adjustment, we must surely assume that Congress would have said so in clear language.

There is more merit in the taxpayer's alternative contention (Br. in No. 28, pp. 47-50) that Section 270 is inapplicable to this case as a whole because of the fact that the reorganization proceedings pursuant to which the taxpayer was formed were no longer "pending" when the Chandler Act was adopted, having been terminated by a final decree entered on March 1, 1937 (R.

187). As a matter of statutory construction it is a plausible argument that Section 276c.(3), in providing for the application of Sections 268 and 270 to "any plan confirmed under section 77B" before September 22, 1938, was intended merely as a modification of the general direction that Section 77B should continue to govern cases originated under that section and still pending when the Chandler Act became effective. However, there is serious doubt whether this contention is open to consideration at the present time. The contention, so far as appears, was not raised in the courts below; and though it was adumbrated in the petition in No. 28 (pp. 19-20), it is inconsistent with the relief prayed in that petition, which was affirmance of the Tax Court's decision that Section 270 applied to the tax year 1938. Moreover, the contention, although plausible, is not, we submit, convincing. The express provision of Section 276c.(3) is that Sections 268 and 270 "shall apply to any plan confirmed under section 77B"—not to any plan so confirmed in a proceeding still "pending" on September 22, 1938. Sections 268 and 270, although contained in a reorganization act, are essentially provisions of tax law, and as such must reasonably be assumed to relate to events which are significant from the point of view of tax law. In the procedure of reorganizations a final decree may be important as tying up the loose ends of administration, discharging

the responsibility of officers of the court, and formally closing the case as a matter of court record. The actual change of rights, however, which motivates tax consequences, does not wait upon final decree; it is customarily—as it was here (R. 84-91)—effected by the order confirming the plan. By that order new interests are created, the enforcement of old claims is barred or enjoined, the contours of the reorganization are, for all practical purposes, irrevocably fixed. Even the reservation of judicial jurisdiction is confined to the entry of further orders “necessary and proper in connection with carrying out the terms and provisions” of the plan already judicially approved and factually consummated in all but procedural respects. The *locus poenitentiae* suggested by the taxpayer (Br. in No. 28, p. 49) as still persisting prior to final decree is more theoretical than real; regardless of the entry of final decree, the unravelling of a plan of reorganization once approved and consummated would pose practically insuperable mechanical obstacles. If, as we believe,—and as the taxpayer for this branch of its argument concedes—Congress in Sections 268 and 270 of the Bankruptcy Act sought to revise the tax consequences of Section 77B reorganizations for at least some tax years preceding 1938, it is irrational to suppose that the effectiveness of the revision was intended to depend upon the fortuitous circumstance of the speed with

which the officials in charge might have happened to wind up the clerical and administrative details and secure their quittance from the court.

In support of both its alternative contentions the taxpayer seeks to enlist a general judicial reluctance to retroactive construction of legislation. However, retroactivity, although not to be presumed in the absence of indications of legislative intent, is not in itself either extraordinary or improper in tax legislation, and in relation to basis adjustments may even be said to be normal. Nor does such retroactivity, as the taxpayer suggests (*Br.* in No. 28, p. 47), infringe its constitutional rights. It is well established that a tax is not necessarily unconstitutional because retroactive. *Milliken v. United States*, 283 U. S. 15, 21. In *Welch v. Henry*, 305 U. S. 134, this Court explored in some detail the considerations bearing upon the possible unconstitutionality of retroactive tax features, approaching the question with sensitive regard for the "delicate and difficult task" of equitably distributing the costs of government through the medium of an income tax. As the Court there said (p. 147):

In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that

* Occasionally the Revenue Acts have altered the computation prospectively from the year of enactment, but this has been done by specific statutory treatment. See, e. g., Section 121 (c) (3) and (e), Revenue Act of 1943, Pub. L. 235, 78th Cong., 2d Sess.; cf. *id.*, Section 122.

its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

As *Welch v. Henry* shows, the extent of the statute's retroactive reach in point of time may be one element bearing upon its constitutionality; and the decision of that case doubtless goes no further in this respect than "that the 'recent transactions' to which this Court has declared a tax law may be retroactively applied * * * must be taken to include the receipt of income during the year of the legislative session preceding that of its enactment" (p. 150). But the opinion conveys no implication of the decisiveness of a mechanically applied time factor. Here, the reasonableness of the time factor is to be gauged by its relationship to the congressional purpose of affording retroactive relief in Section 77B reorganizations. Section 270 is not so much a new tax, levied upon a freshly selected object theretofore supposed to be free of tax, as it is a condition or qualification of a tax benefit which Congress decided to confer retroactively in order to avoid hardship. From the hindsight of four years' experience with Section 77B, Congress found judicial and administrative confusion in the taxation of income arising from cancellations of indebtedness, and determined to cut the Gordian knot by a special exemption

which would settle the question for Section 77B reorganizations, regardless of what might ultimately be held to be the correct rule in other situations.³⁷ In these circumstances, the imposition of a compensatory basis requirement coterminous with the relief provision, even though in individual cases it might result in an upward revision of tax for open tax years, is, we submit, neither harsh nor oppressive within the meaning of the due process clause as it has hitherto been interpreted by this Court.³⁸

³⁷ The taxpayer suggests (Br. in No. 28, pp. 53-54) that under our construction Section 270 might be applicable to some reorganizations which had been consummated in 1934 and which therefore, because of the three-year income tax statute of limitations, could have secured no benefit from Section 268. However, Section 77B had become effective as recently as June 7, 1934, and in view of the time normally taken in working out and consummating reorganization plans it could reasonably have been supposed in 1938 that the number of reorganized corporations with tax years no longer open would be so small as to be negligible.

³⁸ The fact that in some individual cases Section 270 might apply to taxpayers who had received no relief by virtue of Section 268—because in the particular case even without Section 268 the reorganization might have been held tax-free—does not impeach the reasonableness of the congressional decision to eliminate uncertainties by a blanket exemption and to qualify the exemption in order to prevent undeserved windfalls. Cf. the doctrine applicable in police power cases, *Purity Extract Co. v. Lynch*, 226 U. S. 192, 201-202.

III

THE TAX COURT CORRECTLY HELD THAT SECTION 270 OF THE BANKRUPTCY ACT, AS AMENDED, REQUIRED A DECREASE OF THE TAXPAYER'S BASIS TO THE EXTENT OF THE ACCRUED UNPAID INTEREST ON THE BONDS

The Tax Court, although rejecting the Commissioner's contention that Section 270 required a decrease in the taxpayer's basis to the extent of the difference between the principal of the bonds and the value of the stock, nevertheless held (R. 197) that for the year 1938—the only year for which the Tax Court conceded the section's application—such a decrease was required to the extent of \$80,002.20 of accrued unpaid interest.³⁹ The circuit court of appeals found it unnecessary to discuss the correctness of this holding, since the decrease which it held to be required by the cancellation or reduction of principal was in any event sufficient to lower the basis to the "floor" or fair market value of the property.⁴⁰ The question will similarly remain academic in this Court unless the Court should reverse the judgment below on the

³⁹ Section 270 by its terms excludes from the write-down requirement "accrued interest unpaid," but only if "not resulting in a tax benefit on any income tax return."

⁴⁰ Although the circuit court of appeals failed to discuss the interest question, its conclusion and mandate purported to affirm the decision of the Tax Court thereon (R. 237). It would thus seem that the courts below agreed on the disposition of this issue.

issue treated in Point I of this brief.⁴¹ However, since this Court granted certiorari in No. 29 as well as in No. 28, we discuss the question as if the decision on Point I were adverse to our contentions.⁴²

We do not understand the taxpayer to contend that the accrued unpaid interest was not "canceled" within the meaning of Section 270. Rather, the taxpayer relies on the clause of Section 270 which excludes from consideration unpaid interest "not resulting in a tax benefit on any income tax return." The taxpayer contests the decision of the Tax Court on the ground that there was no evidence to show that any income tax benefit had been taken, and on the further ground that the question had not been properly placed in issue (Br. in No. 29, pp. 20-27).

⁴¹ Of course, the question will also remain academic if this Court should disagree with both courts below, and hold that Section 270 is totally inapplicable to the case because the reorganization proceedings were no longer "pending" at the time of the adoption of the Chandler Act. Assuming that this Court's decision on the main issues (treated in Points I and II above) is such as to render the issue as to interest no longer academic, the prayer of the petition in No. 29 (p. 5) is in the alternative—that this Court either "decide this petition [No. 29] or remand the case to the Circuit Court of Appeals for the Seventh Circuit to decide * * * on the merits."

⁴² If this Court should reverse on Point I, but should agree with our contentions as to retroactivity under Point II and as to the interest item under this Point III, the Tax Court should be directed to modify its decision to the extent of requiring a decrease of basis in the amount of the accrued unpaid interest for the years 1935-1937 as well as 1938.

It is true that no evidence of tax benefits was before the Tax Court. However, the Tax Court found that the interest was due, and "was forgiven rather than transformed into stock" (R. 197), and no question is made as to the adequacy of the record to support this finding.³ If the taxpayer desired to bring itself within the special exclusion of Section 270 for interest "not resulting in a tax benefit on any income tax return," the burden lay on it to establish the necessary facts. Since it failed to introduce any evidence on the issue, the Tax Court properly assumed the point in favor of the Commissioner. Whether or not it be true, as the taxpayer now urges (Br. in No. 29, pp. 23-25), that the record would have supported a factual inference that no income tax benefit had been taken, the failure of the Tax Court to adopt such an inference is clearly not grounds for review in the appellate courts. See *Helvering v. Ward*, 79 F. (2d) 381 (C. C. A. 8), and cases cited therein.

6 Nor is there merit in the taxpayer's claim that the interest question was not properly in issue in the Tax Court. The Commissioner based his position on Section 270, claiming that under that section the taxpayer's basis must be reduced to fair market value (R. 194-195). This claim

³ The record did not disclose the amount of the interest thus forgiven, but the sum was determined by agreement of the parties under Rule 50 of the Tax Court (R. 206), and the accuracy of the computation has not been disputed.

placed on the Tax Court the duty of determining whether as a matter of law Section 270 applied in whole or in part. In determining that on the facts presented the section applied in part, the Tax Court was clearly determining a question placed in issue by the Commissioner. The taxpayer cannot be heard to complain merely because it failed to present facts sufficient to show its right to an exclusion from the statute's operation.

IV

THE ORIGINAL COST OF THE BUILDING AND THE PROPRIETY OF CERTAIN DEDUCTIONS CLAIMED FOR DECORATING EXPENSES WERE PURELY QUESTIONS OF FACT, ON WHICH THE TAX COURT'S FINDINGS SHOULD BE ACCEPTED AS CONCLUSIVE.

The taxpayer in its petition in No. 29 assigns as additional error the refusal of the court below to reverse the findings of the Tax Court as to the original cost of the building," and as to the propriety of certain small deductions claimed in 1937

"As with the question discussed in Point III, this question, which likewise relates only to the proper basis of the property in the hands of the taxpayer, is academic unless this Court rejects our view as to the cancellation or reduction of the principal of the bonds, or holds that Section 270 is totally inapplicable because the reorganization proceedings were no longer pending in 1938. The court below found it unnecessary to consider the question, although, as with the interest question (see footnote 40, *supra*), its mandate affirmed the Tax Court's decision on the point.

for decorating expenses.⁴⁵ Both questions were purely factual in nature, and in the state of the record neither presents any ground for reversal by a reviewing court. See *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231.

(a) The Tax Court found (R. 184) that the original cost of the building to the Building Corporation was \$385,326.37. In so finding, the Tax Court refused to include an alleged 10% contractor's commission of \$38,516.91 on an asserted construction cost of \$385,169.15 (R. 25-26),⁴⁶ basing its refusal on the ground that "the petitioner's witness failed to convince us that any amount was actually paid by the old company for contractor's services, or that the original stock issue in fact covered any more than the land" (R. 198).

We submit that the record discloses no ground to impeach the Tax Court's finding in this respect. The taxpayer's sole witness was Charles F.

⁴⁵ The taxpayer also objects (Br. in No. 29, pp. 3, 28-a) that the Tax Court improperly permitted the Commissioner to change the rate of depreciation previously allowed for ten years "without any evidence to guide it and without this being an issue in the case." Since the rate thus previously allowed was 3% (Br. in No. 29, p. 28-a), and the rate allowed by the Commissioner in computing the deficiency here in litigation was 4% (R. 16), we are at a loss to understand the burden of the taxpayer's complaint.

⁴⁶ The difference between the asserted construction cost of \$385,169.15 and the original cost found by the Tax Court (\$385,326.37) is presumably to be accounted for by certain "odds and ends" claimed by the taxpayer as part of the original cost (R. 25-26). The total original cost claimed by the taxpayer, including contractor's commission, was \$424,609.19 (R. 26, 184).

Henry, who had originally transferred the lot to the Building Corporation in return for its capital stock, and had then served as contractor to construct the building. He produced the Building Corporation's account book, which he had kept in his own handwriting, and testified that a pencil notation by him therein represented a "10 percent general contractor's profit" on a construction cost of \$385,169.15 (R. 25-26). This scanty testimony clearly justified the Tax Court's reluctance to conclude that any contractor's commission had in fact been paid, so as to become a part of the cost of the building to the Building Corporation. Certainly the determination of the value of such equivocal testimony on a factual issue on which the taxpayer had the burden of proof is a matter peculiarly within the province of the Tax Court. Cf. *Beaumont v. Helvering*, 73 F. (2d) 110 (App. D. C.), certiorari denied, 294 U. S. 715.

The taxpayer asserts (Br. in No. 29, p. 18) that the Commissioner, having accepted for 15 years a basis for depreciation which included the contractor's commission in question, is "estopped at this late date to question this cost figure." The contention is without merit. The authority of the Commissioner to redetermine a tax liability is settled. *Burnet v. Porter*, 283 U. S. 230; *Virginian Hotel Co. v. Helvering*, 319 U. S. 523. "So far as the argument asserts that, having passed the earlier returns, the commissioner in some

way disabled himself from later correcting his error, it is so plainly unsound as to need no discussion." *Sedley v. Heering*, 77 F. (2d) 323, 324 (C. C. A. 2).

(b) The Tax Court also held that the taxpayer was not entitled to two small deductions in 1937 for decorating and repairs, because the same deductions for the same purposes had been claimed and allowed in 1936. The testimony offered on the issue of duplication of the deductions was vague and uncertain (R. 32, 68, 71). The issue was purely factual, and the circuit court of appeals was clearly right in saying (R. 237): "Our conclusion on this issue is that the evidence is conflicting, and we cannot disturb a finding which has evidence to support it." The same course should be followed by this Court.

CONCLUSION

The judgments of the circuit court of appeals should be affirmed on each of the issues involved.
Respectfully submitted.

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OCTOBER 1944.

APPENDIX

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Chandler Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancelation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter.

(11 U. S. C., Sec. 668.)

SEC. 269. Where it appears that a plan has for one of its principal purposes the avoidance of taxes, objection to its confirmation may be made on that ground by the Secretary of the Treasury, or, in the case of a State, by the corresponding official or other person so authorized. Such objections shall be heard and determined by the judge, independently of other objections which may be made to the confirmation of the plan, and, if the judge shall be satisfied

that such purpose exists, he shall refuse to confirm the plan.

(11 U. S. C., Sec. 669.)

SEC. 270 [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section.

(11 U. S. C., Sec. 670.)

SEC. 276.

c. the provisions of sections 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform

system of bankruptcy throughout the United States", approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient.

(11 U. S. C., Sec. 676.)

Article 22 (a)-14 of Treasury Regulations 86 under the Revenue Act of 1934, as amended by T. D. 4871, 1938² Cum. Bull. 130, 133:

ART. 22 (a)-14. *Cancellation of indebtedness.*—(a) *In general.*—The cancellation

of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See article 22 (a)-18.) If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

(b) *Proceedings under Bankruptcy Act.*—Income is not realized by a taxpayer by virtue of the discharge, under section 14 of the Bankruptcy Act, as amended, of his indebtedness as the result of an adjudication in bankruptcy, or by virtue of an agreement among his creditors not consummated under any provision of the Bankruptcy Act, as amended, if immediately thereafter the taxpayer's liabilities exceed the value of his assets. Furthermore, income is not realized in any case by a taxpayer in the case of a cancellation or reduction of his indebtedness under (1) a plan of corporate reorganization confirmed under section 77B of the Bankruptcy Act, as amended, or (2) a composition agreement confirmed under either section 12 or 74 of such Act. If, however, such plan of corporate reorganization or agreement of composition had for one of its principal purposes the avoidance of income tax, the cancellation or reduction of indebtedness, under such plan or agreement confirmed under section 12, 74, or 77B of the Bankruptcy Act, as amended, may result in the realization of income.

For adjustment of basis of certain property in the case of cancellation or reduction of indebtedness required by the Bankruptcy Act, as amended by the Act of June 22, 1938 (Public, No. 696, Seventy-fifth Congress), see article 113(b)-2.

Article 22(a)-14 of Treasury Regulations 94 under the Revenue Act of 1936, as amended by T. D. 4871, 1938-2 Cum. Bull. 130, 132:

ART. 22(a)-14. *Cancellation of indebtedness.*—(a) *In general.*—The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by payment or purchase of his obligations at less than their face value. (See article 22(a)-18.) If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

(b) *Proceedings under Bankruptcy Act.*—Income is not realized by a taxpayer by virtue of the discharge, under section 14 of the Bankruptcy Act, as amended, of his indebtedness as the result of an adjudication in bankruptcy, or by virtue of an agreement among his creditors not consummated under any provision of the Bankruptcy Act, as amended, if immediately thereafter the taxpayer's liabilities exceed the value of his assets. Furthermore, income is not realized in any case by a taxpayer in the case of a cancellation or reduction of his indebtedness under—

(1) a plan of corporate reorganization confirmed under either section 77B or Chapter X of the Bankruptcy Act, as amended;

(2) a composition agreement confirmed under either section 12 or 74 of the Bankruptcy Act, as amended;

(3) an "arrangement" or a "real property arrangement" confirmed under Chapter XI or XII, respectively, of the Bankruptcy Act, as amended; or

(4) a "wage earner's plan" confirmed under Chapter XIII of the Bankruptcy Act, as amended.

If, however, such plan of corporate reorganization or agreement of composition referred to in (1) to (4) above had for one of its principal purposes the avoidance of income tax, the cancellation or reduction of indebtedness, under such plan or agreement confirmed under section 12, 74, or 77B or under Chapter X, XI, XII, or XIII of the Bankruptcy Act, as amended, may result in the realization of income.

For adjustment of basis of certain property in the case of cancellation or reduction of indebtedness required by the Bankruptcy Act, as amended by the Act of June 22, 1938 (Public. No. 696, Seventy-fifth Congress), see article 113 (b)-2.

Article 113 (b)-2 of Treasury Regulations 86 under the Revenue Act of 1934, as added by T. D. 4871, 1938-2 Cum. Bull. 130, 134-135, and as amended by T. D. 5003, 1940-2 Cum. Bull. 107, 108-109:

ART. 113 (b)-2. *Adjusted basis: Cancellation of indebtedness.*—In addition to the adjustments provided in section 113 (b) (1)

and article 113 (b)-1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any proceeding under section 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B of the Bankruptcy Act of 1898, as amended. Such further adjustment shall be made in the following manner and order:

(1) In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable) whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, which indebtedness shall have been canceled or reduced in any such proceeding, the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness so incurred with respect to such property shall have been canceled or reduced;

(2) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the cancellation or reduction of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness secured by such lien shall have been canceled or reduced;

(3) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced in such proceeding over the sum of the adjustments made under (1).

and (2) shall next be applied to reduce the cost or other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by (1) and (2) as follows: The cost or other basis of each unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis (after adjustment under (1) and (2)) of each such unit of property bears to the sum of the adjusted bases (after adjustment under (1) and (2)) of all the property of the debtor other than inventory and notes and accounts receivable;

(4) Any excess of the total amount by which such indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (1), (2), and (3) shall next be applied to reduce the cost or other basis of any units of property covered by (1), (2), and (3) which have a remaining basis (after adjustment under (1), (2), and (3)) greater than their fair market value as follows: The cost or other basis of each such unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the remaining basis of each such unit bears to the sum of the remaining bases of such units. The process shall be repeated until the cost or other basis of each unit of the property covered by (1), (2), and (3) is reduced to its fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value; and

(5) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (1), (2), (3), and (4) shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows:—The cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable. The process shall be repeated until the adjusted bases of inventory, notes receivable and accounts receivable are reduced to their fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value.

For the purposes of this article—

(A) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(B) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(C) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not

have resulted in a tax benefit in any income tax return;

(D) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay; and

(E) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this article.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this article.

Article 113 (b)-2 of Treasury Regulations '94 under the Revenue Act of 1936, as similarly added and amended, is identical with Article 113 (b)-2 under Regulations 86, except that the last clause of the first sentence reads:

or 77B or under Chapter X, XI, or XII of the Bankruptcy Act of 1898, as amended.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1944.

CLAYBROOK APARTMENTS COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

On Writ of Certiorari to the Circuit Court of Appeals for
the Seventh Circuit.

BRIEF OF AMICUS CURIAE.

H. BRIAN HOLLAND,
Amicus Curiae.

HOMER HENDRICKS,
Of Counsel.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1944.

No. 28, 29.

CLARIDGE APARTMENTS COMPANY, *Petitioner*.

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Writ of Certiorari to the Circuit Court of Appeals for
the Seventh Circuit.

**PETITION FOR LEAVE TO FILE BRIEF AS AMICUS
CURIAE.**

The undersigned respectfully petitions this Honorable Court for leave to file the accompanying brief in this case as *amicus curiae*. The Solicitor General and counsel for the taxpayer have assented in writing; as indicated by letters filed with the clerk of this Court.

Respectfully submitted,

H. BRIAN HOLLAND.

October, 1944.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 28, 29.

CLARIDGE APARTMENTS COMPANY, *Petitioner*.

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Writ of Certiorari to the Circuit Court of Appeals for
the Seventh Circuit.

BRIEF OF AMICUS CURIAE.

Scope of Brief.

This brief is directed solely to the question whether indebtedness of a corporation is "canceled or reduced", within the meaning of Section 270 of the Bankruptcy Act (*infra*, p. 15), when, in a reorganization proceeding under Section 77B or Chapter X of that Act, stock having a fair market value lower than the face amount of the corporation's bonds is issued in exchange for those bonds. We submit that this question should be answered in the negative.

Ambiguity of the Statute.

The question is manifestly one of statutory interpretation, requiring a determination of what Congress meant by the words "canceled or reduced". The court below thought it sufficient to say that those words should be taken in their broadest and most literal sense. It said:

"The words 'canceled or reduced', as used in this statute, are comprehensive. Given their ordinary or literal meaning, they cover a case such as is here presented. Here there was an elimination of the bonded indebtedness."

And, again

"* * * In the instant case the debt was entirely eliminated. In place thereof, stock of much less market value than the face value of the debt was issued."

Clearly there can be no quarrel with the view that the substitution of stock in place of the outstanding bonds "entirely eliminated" the indebtedness which the bonds represented. However, to regard "canceled" as being synonymous with "entirely eliminated" would lead to results which Congress obviously cannot have intended. The "literal" interpretation advanced by the court below proves too much. Thus, indebtedness may be eliminated by full payment, on the one hand, or by forgiveness, on the other. By payment and forgiveness alike the debt is extinguished, canceled and reduced to zero. Yet it is doubtful whether anyone would seriously contend that Section 270 was applicable with respect to a cancellation of indebtedness by satisfaction in full.

Similarly, indebtedness may be said to be "reduced" by partial payment or forgiveness. If the debts of a company prior to reorganization total \$50,000 and after the reorganization they are only \$25,000, the indebtedness has been "reduced" by \$25,000. But that reduction may have been effected by payment of \$25,000 in cash and issuance of bonds or notes for the balance, or by the "gratuitous" cancellation of the debts to the extent of \$25,000. If \$25,000

were paid in cash and \$25,000 in notes, Section 270 would, we submit, clearly require no reduction of basis. On the other hand, if \$25,000 were canceled without consideration, a basis reduction of \$25,000 would presumably be in order. Yet the indebtedness of the company would literally have been "reduced" by \$25,000 in both cases.

It seems obvious, therefore, that Section 270 cannot be invoked by a mere showing that the debtor company's indebtedness has been "entirely eliminated" or is smaller after the reorganization than it was before. Congress evidently did not use the words "canceled or reduced" in that broad, literal sense. What, then, did Congress intend? The answer to that question can be determined only by examining Section 270 in the light of the circumstances which led to its enactment, and by viewing it against the background of the income tax laws of which—notwithstanding its incorporation in the Bankruptcy Act—it is essentially a part. *Helvering v. Morgan's, Inc.*, 293 U. S. 121, 126; *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84, 93-94.

Legislative History.

Sections 268 and 270 owe their existence to the decision of this Court in *United States v. Kirby Lumber Co.*, 284 U. S. 1, holding that taxable income resulted from the purchase by a corporation of its bonds for less than the price at which they had been issued. That decision, handed down in 1931, was followed by a long line of cases in which debt reduction, effected under varying circumstances, was held to give rise to income subject to taxation.

When the Chandler Act was under consideration, it was feared by its proponents that application of the principle of the *Kirby Lumber Co.* case might materially interfere with the readjustments which that Act was designed to facilitate and encourage. Accordingly, there was included in the bill as reported by the House Judiciary Committee a provision designed to prevent the imposition of any income

tax upon gain or profit resulting from the "modification in or liquidation in whole or in part of" any indebtedness of the debtor in a plan consummated under the Act. (See H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55, 56, 111.) That provision, with certain changes in phraseology suggested by the Senate, was enacted as Section 268. (See S. Rep. No. 1916, 75th Cong., 3rd Sess., p. 7.)

The Treasury Department offered no objection to the substance of Section 268, but urged the adoption of a complementary provision requiring reduction of basis of the debtor's assets to compensate for the loss of revenue which would result from the enactment of that section, lest "what is originally intended to be a relief provision * * * turn out * * * to be an unwarranted grant of tax reduction." (See letter of Roswell Magill, Acting Secretary of the Treasury, January 14, 1938, printed in Hearings Before a Subcommittee of the Committee on the Judiciary, United States Senate, 75th Cong., 2d Sess., on H. R. 8046, at p. 144.) That provision, described as being "intended to avoid a double deduction", was written into the Act as Section 270. (See S. Rep. No. 1916, *supra*, at pp. 7, 39.)

This brief sketch of the legislative history of Sections 268 and 270 suffices, we believe, to make it clear that they were intended as relief provisions; that Section 270 was intended to complement Section 268; and that together the two sections were designed to defer the recognition of income or profit which would otherwise be taxable in the year in which the plan of reorganization became effective.

Application of Section 270 Limited by Section 268.

The considerations outlined above afford strong support for the argument that Section 270 should be interpreted as calling for a reduction of basis only if and to the extent that taxable income would have been realized upon the reorganization in the absence of the specific exemption conferred by Section 268. The materials in support of that interpretation are set forth in greater detail in the taxpayer's brief and need not be elaborated here. We believe

the interpretation to be sound and in accord with the actual intent of Congress. Moreover, it is a logical and sensible interpretation. It is understandable that Congress should have deemed it proper to exact a *quid pro quo*, in the form of a basis adjustment, for benefits conferred by Section 268, but it is difficult, indeed, to perceive any reason why Congress should have desired to impose the burden of a reduction in basis where no corresponding benefit was conferred by the companion section. And we submit that there is no necessity for concluding that Congress had any such intention once it is recognized that the words "canceled or reduced" cannot in any event be taken in their strictly literal sense.¹²

If the interpretation suggested above is the correct one, we submit there can be little doubt that Section 270 does not apply to indebtedness eliminated by means of a substitution of stock for bonds in a purely capital transaction. "In essence this is a capital transaction like an ordinary subscription for stock, involving realization of no gain or loss by the corporation." Darrell, *Discharge of Indebtedness and the Federal Income Tax*, 53 Harvard L. Rev. 977, 998. The Board of Tax Appeals (now the Tax Court) has consistently so held, usually in response to the contentions of the Commissioner to that effect. The question has arisen in two groups of cases. In the first, and earlier, group the Board, sustaining the Commissioner, held that a corporation might not deduct unamortized bond discount in a year in which the bonds were retired by the issuance of stock in exchange therefor. *Chicago, Rock Island & Pacific Railway Co. v. Commissioner*, 13 B. T. A. 988, affirmed, 47 F. (2d) 990 (C. C. A. 7th), cert. den., 284 U. S. 618; 375 *Park Avenue Corp. v. Commissioner*, 23 B.

¹² It has been suggested that an interpretation which would permit "reduction of basis below cost without relation to the extent to which gain would otherwise be taxable" would raise a serious constitutional question. Warren and Sugarman, *Cancellation of Indebtedness and Its Tax Consequences*, 41 Col. L. Rev. 61, 77; Darrell, *Discharge of Indebtedness and the Federal Income Tax*, 53 Harv. L. Rev. 977, 1010.

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T. A. 969 (Acq. X-2 C. B. 70); *Pierce Oil Corp. v. Commissioner*, 32 B. T. A. 403; *Liquid Carbonic Corp. v. Commissioner*, 34 B. T. A. 1191.¹ See, also, L. T. 2347, VI-1 C. B. 86; G. C. M. 9674, X-2 C. B. 754; T. D. 4603, XIV-2 C. B. 58. The theory of these decisions and rulings is summarized in the *Liquid Carbonic Corp.* case as follows (p. 1196):

"The ground upon which these decided cases stand is that the conversion of bonds into capital stock of the obligor is purely a capital transaction; that is, a readjustment of the obligor's capital structure, which does not result in either a deductible loss or a taxable gain. The obligor does not pay out anything. It merely readjusts its capital. As we said in *375 Park Avenue Corporation, supra*, 'Instead of suffering the outlay of money in excess of the amount borrowed, it created a new distribution of its shares, thus avoiding its fixed financial obligation and devoting the borrowed money to the ordinary risks of its business'."

So far as we are aware, the Commissioner still follows the rule laid down by the above authorities, although it seems entirely inconsistent with his present contention that gain or loss may be realized by a corporation which retires its bonds by issuing stock therefor. See Mertens, *Law of Federal Income Taxation*, § 12.116.

The second group of cases includes, in chronological order, *Carpenter Securities Corp. v. Commissioner*, 47 B. T. A. 691, affirmed, 140 F. (2d) 382 (C. C. A. 1st); the instant case; and *Alcazar Hotel, Inc. v. Commissioner*, 1 T. C. 872, now pending on appeal to the Circuit Court of Appeals for the Sixth Circuit. Of these three cases, only the present case and the *Alcazar* case involved Section 270 of the Bankruptcy Act, but the decisions of the Tax Court in both of them were expressly based on the principles stated by the

¹ It may be noted that, although the first two of these cases antedated the change in the attitude of the courts towards retirement of debt at a discount (*United States v. Kirby Lumber Co., supra*) and towards the tax significance of dealings by a corporation in its own stock (*Commissioner v. S. A. Woods Machine Co.*, 57 F. (2d) 635 (C. C. A. 1st)), the last two were decided subsequent to those changes. See 34 B. T. A. at p. 1197.

Board in the *Capento* case. That case raised squarely the question whether a corporation realized taxable gain upon the issuance of stock in retirement of its bonds, the fair market value of the stock being less than the principal amount of the bonds. The Tax Court adhered to the view that this kind of transaction is essentially a capital transaction, and held that there was no "present realization of gain". The Circuit Court of Appeals stated its agreement with that conclusion, and added (p. 386) that in any event the question was "only a question of proper tax accounting" in which the decision of the Board is controlling on the courts, there being no provision of statute or regulation specifically requiring a contrary holding."

Two other opinions of individual Board members (i. e., not reviewed by the full Board) should be mentioned in the interest of completeness. Both cases involved the deductibility of bond interest accruing during the portion of a year prior to the retirement of the bonds with stock. In each case the Board member, apparently assuming—or in any event suggesting the possibility—that the obligor corporation might have realized a gain to the extent of the difference between the fair market value of the stock and the amount of the obligations for principal and interest on the bonds, said that recognition of gain, if any, was prevented by Section 112(b)(3) of the Revenue Act of 1934 relating to exchanges of securities in a reorganization. *Hummel-Ross Fibre Corp. v. Commissioner*, 40 B. T. A. 821, 823 (Acq. 1940-1 C. B. 3); *Shamrock Oil & Gas Co. v. Commissioner*, 42 B. T. A. 1016, 1018 (Acq. 1940-2 C. B. 6). These observations appear to have been unnecessary to the disposition of the cases in respect of which they were made. In any event, so far as the present question is concerned it makes no difference whether there is no realization of income or realized income is non-recognized, since in either case there is no need for the company to avail itself of the benefits of Section 268 of the Bankruptcy Act.

The very paucity of cases presenting the question whether a corporation can have taxable income when it issues stock

in retirement of bonds strongly suggests a negative answer. The *Capento Securities* case, *supra*, appears to have been the first case in which the Commissioner of Internal Revenue ever attempted to collect a tax upon a capital readjustment of that type, and the opinion of the Circuit Court of Appeals intimates that the attempt in that case was attributable to certain peculiar facts there present. It seems entirely reasonable to assume that the administrative authorities have, until recently, agreed with the position of the Board of Tax Appeals that there is no realization of income or loss upon a substitution of stock for bonds in a recapitalization or reorganization. We submit that, even if there is room for difference of opinion as to the correct theory, the question is one as to which the judgment of the Board (now the Tax Court) should be accepted as final in the absence of any controlling statute or regulation. Cf. *Dobson v. Commissioner*, 320 U. S. 489.

Section 270 Inapplicable Here Even if Construed Without Regard to Section 268.

Although we believe the interpretation of Section 270 suggested above to be sound and in accord with the actual legislative intent, it is not necessary, in order to establish the inapplicability of that section to the present case, to limit its application to debt readjustments that would have given rise to taxable income in the absence of Section 268. We submit that, quite apart from Section 268, the language of Section 270, if given its ordinary and natural meaning, cannot be construed as requiring a reduction of asset basis in the case of a substitution of stock for bonds in a reorganization.

We think it will be conceded that the words "the amount by which the indebtedness of the debtor * * * has been canceled or reduced" cannot be taken in their most literal sense as including that part of the indebtedness which is discharged by satisfaction, and that they must be construed as referring only to that part, if any, which is discharged

without consideration, or is "forgiven".² That being so, the question is whether, in this type of case, the indebtedness represented by the bonds is to be regarded as having been satisfied by the issuance of stock, or whether some part of it is to be regarded as having been forgiven—and, if so, how much.

The government's argument is, in substance, that the indebtedness is satisfied to the extent of the fair market value of the stock, and that the balance is forgiven and thus represents the amount by which the indebtedness is canceled or reduced within the meaning of Section 270. We submit, however, that this contention is inconsistent with both the ordinary view and the tax treatment of this type of transaction.

It has been said that "in popular parlance no one would ordinarily use the words 'canceled or reduced' in speaking, for example, of the conversion of debt into stock in a purely capital transaction." Darrell, *Discharge of Indebtedness and the Federal Income Tax*, 53 Harvard L. Rev. 977, 1009. The reason for this is, we submit, that those words import a finality which is lacking in a capital readjustment of this kind. Even though the stock had a readily ascertainable cash value, the conversion would not ordinarily be regarded as involving a payment of that amount and a forgiveness or cancellation of the remainder of the debt. It would normally be considered to involve neither payment nor forgiveness, but rather a "reshuffling of a capital structure" (*Hydrex v. Southwest Consolidated Corp.*, 315 U. S. 194, 202) entailing postponement of a final closing of the transaction between the parties.

So far as tax treatment is concerned, it is hardly necessary to point out that for many years exchanges of stock for bonds pursuant to recapitalization or similar reorganization plans have been treated as continuing, rather than

²It is to be noted that the word "forgiveness" is used in the Report of the Senate Judiciary Committee, quoted at p. 33 of the taxpayer's brief.

closed, transactions for federal income tax purposes. See Section 202(b) of the Revenue Act of 1918, c. 18, 40 Stat. 1057. The loss technically sustained by the bondholder if the fair market value of the stock which he receives is less than the cost of his bonds is not "recognized" and may not be deducted on his tax return. He is not treated as having received payment or satisfaction in part and forgiven the balance of the debt, but, on the contrary, is treated as if there had been no change whatever in his position vis-à-vis the corporation. And, as we have shown elsewhere in this brief (*supra*, pp. 7-8) a substitution of stock for bonds in a capital readjustment has, except for the decision below, consistently been regarded by the Board of Tax Appeals and the courts—and, until recently, by the administrative authorities as well—as wholly without significance to the corporation concerned.

We submit that under the circumstances it would require far plainer language than is to be found in Section 270 to justify the conclusion that a forgiveness or cancelation of indebtedness measured by the difference between the face amount of the debt and the fair market value of the stock should be deemed to take place, for the purposes of that section, in a case like the present. It is pure fiction to say that a corporation pays out anything when it issues its own stock. See *Liquid Carbonic Corp. v. Commissioner*, 34 B. T. A. 1191, 1196. Certainly it realizes neither gain nor loss by so doing. Reg. 111, Sec. 29.22(a)—15. Indulgence in the fiction is, we submit, permissible only when the transaction is one which can be treated in all respects as equivalent to an issuance of the stock for cash followed by application of the cash to the purpose for which the stock is issued.³ That condition does not exist in the case of a recapitalization, since the retirement of bonds with cash would have tax

³ Compare treatment of unamortized discount upon retirement of bonds with cash proceeds of sale of stock (*The National Tile Co. v. Commissioner*, 30 B. T. A. 32) with treatment upon exchange of stock for bonds in a recapitalization (*Liquid Carbonic Corp. v. Commissioner*, *supra*).

results materially different from those obtaining where bonds are retired with stock in a capital transaction.

We submit that the situation here is not, as has been suggested, at all comparable to a discharge of indebtedness by a transfer of property in kind. In the case of such a transfer, there is a severance of assets from the debtor corporation, with resulting gain or loss which is recognized as to both debtor and creditor. The transaction may be analyzed as equivalent to a sale of the property for cash which is used to discharge the indebtedness. See Reg. 111, Sec. 29.113(b)(3)-1(E).⁴ That is not true with respect to a capital readjustment. A transfer of an undivided interest in the corporation is altogether different from a severance and transfer of particular assets.

It should be noted, also, that the question whether indebtedness is canceled or reduced within the meaning of Section 270 when stock is issued to the creditor in a transaction not qualifying as a capital transaction—as, for example, when stock is issued in satisfaction of general unsecured claims—is not involved in the present case. The difference between the two situations is significant. When stock is issued to unsecured creditors, it is treated like cash or other property in determining the tax status of the recipients, and for that reason there may be justification for treating it like cash or other property in determining the tax results to the debtor.⁵

⁴ This provision of the regulations is taken almost verbatim from the Ways and Means Committee Report on the Revenue Act of 1939, H. Rep. No. 855, 76th Cong., 1st Sess., p. 25. The courts have generally held, however, that a transfer of assets in satisfaction of debt constitutes a sale of the assets for the amount of debt. See *Rogers v. Commissioner*, 103 F. (2d) 790 (C. C. A. 9th), cert. den. 308 U. S. 580; *Peninsula Properties Co. Ltd. v. Commissioner*, 47 B. T. A. 84. On that theory there would appear to be a payment in full from the standpoint of the debtor.

⁵ It would seem that the Ways and Means Committee must have been thinking of this kind of transaction when, in its report on the 1939 Act, it spoke of cases in which "a discharge of indebtedness is accomplished by the transfer by the debtor of property in kind,

The court below appears to have paid no attention to the fact that a substitution of stock for bonds in a reorganization is not treated as a closed transaction for tax purposes. There is, we submit, nothing "illlogical" or "unfair" in retaining as the tax basis of a company's assets an amount greater than their value as of the date of a reorganization, when the holders of the company's securities are not permitted for tax purposes to write down their investments to a basis commensurate with current values. Particularly is this true in a case like the present one, where the creditors who have sustained the "loss" have become the owners of virtually all the stock of the corporation and will be the persons principally affected by any reduction in the basis of the company's assets.

Conclusion.

The decision below should be reversed in so far as it holds that there was a cancellation or reduction of indebtedness in this case within the meaning of Section 270 of the Bankruptcy Act, as amended.

Respectfully submitted,

H. BRIAN HOLLAND,
Amicus Curiae.

HOMER HENDRICKS,
Of Counsel.

such as by the issue of its own stock." H. Rep. No. 855, 76th Cong., 1st Sess., p. 25. Even as applied to the issuance of stock to general creditors, the language seems singularly inappropriate. As applied to an exchange of stock for bonds in a recapitalization or reorganization, it seems utterly inconsistent with the principles established by the Courts. See comment in Surrey, *The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness*, 49 Yale L. J. 1153, 1172. Note, also, that when the committee statement was incorporated, almost verbatim, in the regulations, the words "such as by the issue of its own stock" were omitted. Reg. 111, Sec. 29.113(b)(3)-1(E).

APPENDIX.

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancelation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter. (11 U. S. C., Sec. 668)

Sec. 270. [as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709]. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section. (11 U. S. C., Sec. 670)

SUPREME COURT OF THE UNITED STATES.

NO. 28, 29.—OCTOBER TERM, 1944.

Claridge Apartments Company, } On Writ of Certiorari to the
vs. } United States Circuit Court
Commissioner of Internal Revenue. } of Appeals for the Seventh
Circuit.

[December 4, 1944.]

Mr. Justice RUTLEDGE delivered the opinion of the Court.

The issues arise out of deficiency assessments made in respect to petitioner's federal income and excess profits taxes for the years 1935 to 1938 inclusive. They involve the applicability of Section 270 of the Bankruptcy Act, as amended,¹ so as to require reduction of depreciation allowances claimed.

¹ Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 904, and the Act of July 1, 1940, c. 500, 54 Stat. 709, 11 U. S. C. §§ 668, 670. Section 270 is complementary to Section 268, with which originally it was enacted as part of Chapter X of the Chandler Act. The two sections are as follows, the italicized portion of 270 constituting the whole of the amendment made in 1940.

"Sec. 268. Except as provided in section 270 of this Act, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in ~~a~~ proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancellation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter."

"Sec. 270. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including interest accrued unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section." (Emphasis added.)

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The transactions arose in connection with a reorganization proceeding under Section 77 B, 48 Stat. 912. They consisted essentially of petitioner's acquisition of all the assets of the insolvent debtor corporation, by an exchange of its capital stock without par value for the latter's bonds then outstanding. The Commissioner contends that the exchange resulted in a cancellation or reduction of indebtedness within the meaning of Section 270, so as to require a corresponding reduction in the basis of the property transferred. Accordingly he now urges that the assessment should be made, as the section requires, upon the basis of the fair market value of the property.² The taxpayer's claim is made on the higher basis of the debtor corporation, in the view that Section 270 is not applicable to such a transaction.

This difference has been the basic one between the parties in proceedings before the Tax Court,³ the Circuit Court of Appeals and here. Others include a similar question with respect to the extinction of the debtor's liability for the accrued unpaid interest on the bonds and whether Section 270 is made applicable retroactively to the years prior to 1938, by virtue of the provisions of Section 276c(3) of the Chandler Act.⁴

The Tax Court decided the principal issue on the merits in favor of the taxpayer, except with respect to the accrued interest. Cf. also *Capento Securities Corp. v. Commissioner*, 47 B. T. A. 691, affirmed, 140 F. 2d 382. It likewise limited the application of Section 270 to the year 1938 and succeeding years. 1 T. C. 163. The Court of Appeals reversed the Tax Court's decision in both respects, holding there was a cancellation of indebtedness with respect to the unpaid principal⁵ and that Section 270 was applicable retroactively to require the prescribed reduction in basis for each of the tax years in question. 138 F. 2d 962. Certiorari was granted. 321 U. S. 759, because of the importance of the questions presented

² Cf. note 1 *supra*. Originally the Commissioner contended that the taxpayer's basis for depreciation was the market value of the property on acquisition in 1935 and this was a major issue before the Tax Court, cf. 1 T. C. 163. But the Tax Court held petitioner had acquired the assets in connection with a reorganization as comprehended by Section 112(g) of the Revenue Act of 1934, and that therefore its basis was the adjusted basis in the hands of the debtor corporation. This ruling was not contested on appeal and is not in question here.

³ Cf. note 2 *supra*.

⁴ The section is set forth in Part III of the opinion.

⁵ Consequently it made no ruling with reference to the accrued interest since the amount of the principal held to have been "cancelled" was more than sufficient to bring the basis down to the fair market value in 1935.

and a conflict on the question of retroactivity.⁶ The facts are stated shortly in the margin, to give concrete perspective.⁷

I.

Petitioner earnestly argues that the Tax Court's decision, so far as this was in its favor, should be affirmed on the authority of *Dobson v. Commissioner*, 320 U. S. 489, though in other respects it seeks a reversal of that court's judgment.⁸ For reasons presently to be stated, we think the case must be disposed of in its entirety by the application of Section 276e(3), which determines the extent to which Sections 268 and 270 are applicable in point of time. Accordingly, we are not required to pass upon the merits of the other interesting issues or whether they fall within the *Dobson* admonition. On the other hand, the question of the applicability of Sections 268 and 270, under the terms of Section 276e(3), to the transactions involved in this case obviously is one of law and of a sort not requiring the specialized experience of the Tax Court to determine. Furthermore, it involves making an accommodation between the conflicting policies, in part, of the

⁶ Cf. *Commissioner v. Commodore*, 135 F. 2d 89 (C. C. A. 6th), holding that Section 276e(3) does not make Sections 268 and 270 retroactively applicable to tax years prior to 1938. The importance of the questions for the future has been minimized by repeal of Section 270 by Section 121 of the Revenue Act of 1943, Pub. L. 235, 78th Cong., 2d Sess.

⁷ The property consists of an apartment building, with furnishings, in Chicago. It was constructed in 1924 by the Claridge Building Corporation at a cost in excess of \$385,000. The corporation at that time issued its 6½ per cent first mortgage bonds for \$340,000. By October 1, 1931, the bonds outstanding amounted to \$277,000. In consequence of defaults, on that date the trustee filed his bill of foreclosure, took possession of the property, and thereafter collected the rents. A decree for foreclosure was entered the following February, but there was no sale and the foreclosure proceeding was never consummated.

On June 16, 1934, the Building Corporation filed its voluntary petition under Section 77 B. In November of that year a plan of reorganization was agreed upon, which was confirmed and approved May 14, 1935. Pursuant to this the taxpayer corporation was organized and the property was transferred to it. Ninety per cent of its shares were issued to trustees for depositing bondholders and to nondepositing bondholders, on the basis of one share of stock for each \$100 face amount of bonds; and ten per cent of the stock was issued to the shareholders in the old corporation. The final decree in the Section 77 B proceeding was entered March 1, 1937.

According to findings of the Tax Court, the fair market value of the building, as of May 14, 1935 (when the plan was confirmed, cf. § 270, note 1 *supra*), was not in excess of \$141,000. The adjusted basis of the taxpayer's predecessor in that year was \$239,377.33, at which time the building had a remaining useful life of twenty-five years. The fair market value of petitioner's stock did not exceed \$45 per share in 1935. The Tax Court also found that the Claridge Building Corporation was insolvent throughout the reorganization proceedings.

⁸ Cf. text *infra* at note 37.

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bankruptcy laws and the revenue enactments. Sections 268 and 270 are integral parts of the former, though related in subject matter to the latter, and were so placed for purposes relevant primarily to that legislation. For these reasons the issue falls beyond the scope of the *Dobson* case.

II.

The question presented by Section 276e(3) must be determined in the light of the problem created by Sections 268 and 270. A statement of their history is necessary to a general understanding of that problem. It stems basically from *United States v. Kirby Lumber Co.*, 284 U. S. 1, and subsequent decisions which have applied the principle of that case.⁹ By them a corporation may realize income from the cancellation or reduction of indebtedness, depending upon the circumstances in which the transaction occurs. However, the line between income producing reductions and others is not precise or definite and great uncertainty prevailed concerning it, both in 1934 when Section 77 B was enacted and in 1938 when Chapter X of the Chandler Act was adopted. The uncertainty was greatest perhaps in relation to transactions occurring in the course of insolvent reorganizations.¹⁰

Some of the obscurity has been created by the very legislation enacted to remove it. This has been true of the successive "reorganization" provisions, including those for "nonrecognition" and for transfer of "basis," which have appeared in the various revenue acts from 1918 (cf. 40 Stat. 1057) forward. Closely related, as these have been, to the problem whether income is realized by the cancellation or reduction of indebtedness in connection with a reorganization, they have tended to obscure if not to blot out that problem altogether in situations covered by their terms.¹¹

By and large the provisions are the product of and have reflected efforts at compromise, none too successful, between the

⁹ Cf., e. g., *Helvering v. American Dental Co.*, 318 U. S. 322; *Kraman Dev. Co.*, 3 T. C. 342; *Paul, Debt and Basis Reduction under the Chandler Act* (1940) 15 *Tulane L. Rev.* 1, 5, and authorities cited in notes 17, 19.

¹⁰ Cf. *Paul, op. cit. supra*, note 9; *Darrell, Discharge of Indebtedness and the Federal Income Tax* (1940) 53 *Harv. L. Rev.* 977; *Darrell, Creditors, Reorganizations and the Federal Income Tax* (1944) 57 *Harv. L. Rev.* 1009; *Banks, Treatise on Bankruptcy for Accountants* (1939) 80-92.

¹¹ By assuming the existence of income or other taxable gain, but providing for nonrecognition, the inquiry whether gain or profit actually has accrued is wholly avoided.

conflicting pulls of policy involved in the revenue acts and in the bankruptcy legislation. They were drawn and enacted however as parts of the revenue laws and have reflected increasingly the policy of that legislation.¹² Accordingly, the succession of statutes relating to this field, prior to Sections 268 and 270, represents a series of shifts in the legislative pendulum from initial broad tax relief, to encourage needed reorganizations, toward narrowed exemption, in order to discourage use of reorganization for evasion of taxes. The general purpose of the provisions, however, was to postpone the tax consequences which otherwise might ensue upon transactions occurring in such circumstances that immediate imposition was regarded as economically unjustifiable.¹³ This continued in the 1934 general revision,¹⁴ which remained in effect during the period of this litigation.

In some respects, as compared with the preexisting legislation, the 1934 provisions broadened, but in others they restricted the scope of application of the principles of nonrecognition and transfer of basis.¹⁵ Nevertheless, they were applicable to all exchanges falling within their terms, whether or not the plan was executed in connection with a judicial proceeding. Consequently, when in June, 1934, Section 77 B was adopted, the 1934 revenue provisions became applicable to reorganizations under that section, but only if they met the tests prescribed in the revenue acts, including such judicially interpolated matters as "continuity of interest" and "business purpose."¹⁶ Many 77 B reorganizations did not qualify under these tests or on substantial grounds were thought not to do so.

¹² Cf. authorities cited note 10 *supra*.

¹³ Cf. Paul, *Studies in Federal Taxation*, Third Series, 4, 5.

¹⁴ §§ 112, 113 of the Revenue Act of 1934, c. 277, 48 Stat. 680, 704, 706.

¹⁵ E.g., Section 112(g) of the 1934 Act redefined what might be a reorganization under the revenue act. Thus Section 112(g)(1)(A) included only statutory mergers or consolidations as revenue reorganizations, but dropped the earlier parenthetical clause; Section 112(g)(1)(B) required that the acquisition of stock or property of another corporation be in exchange solely for all or a part of the voting stock of the acquiring corporation to qualify as a reorganization. *Helvering v. Southwest Consolidated Corp.*, 315 U. S. 194; cf. § 112(b)(5); *Helvering v. Cement Investors, Inc.*, 316 U. S. 527.

¹⁶ Cf. *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U. S. 179; *Palm Springs Holding Corp. v. Commissioner*, 315 U. S. 185; *Marlborough Investment Co. v. Commissioner*, 315 U. S. 189; *Helvering v. Southwest Consolidated Corp.*, 315 U. S. 194; Darrell, *Creditors' Reorganizations and the Federal Income Tax*, (1940) 57 Harv. L. Rev. 1069, 1093, 1033.

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The consequence was seriously to clog the use of the 77 B procedure. Obstacles were imposed not only by the differences in the two statutory definitions of "reorganization," but also by **ambiguities in each definition** which in themselves created considerable areas of uncertainty.¹⁷ And underlying these remained the mystery of when income would be regarded as realized, which continued to haunt reorganizers unsure of whether they could bring themselves within the statutory exemptions. In short, the necessity of squaring the reorganization first with Section 77 B, then with the different terms of the revenue provisions, and the uncertainties involved under each statute in doing this, added to the puzzle of "realized income," made the process of creditors' reorganization under the former act a highly dubious adventure. To an undetermined extent the effect of the revenue act's provisions was to nullify or make impossible of realization the objects of Section 77 B.

In this setting Congress adopted the Chandler Act in 1938. That statute was a general revision of the provisions for bankruptcy reorganization, including those previously made under Section 77 B. One of its principal objects was to encourage the freer use of bankruptcy reorganization in order to avoid unnecessary or premature liquidations. By this time Congress had become aware of the hazardous and hampering effects of the 1934 revenue provisions upon the operation of bankruptcy reorganizations under Section 77 B. The objectives of the Chandler Act, in similar situations, could not be achieved without removal of these impediments. Some provision was essential to prevent them from having the same effects upon the working of the new legislation. Accordingly Section 268 was devised for this purpose and became a part of the Chandler Act itself. It had no other object, and there was no other occasion for its being, than to free Chapter X reorganizations from the tax deterrents, including tax uncertainties, imposed by the existing revenue act provisions.

The relieving effect of Section 268 was confined in three ways, namely, (1) to transactions occurring in a Chapter X reorganization; (2) to transactions involving a modification or a cancellation, in whole or in part, of the debtor's indebtedness; and (3) its benefits were limited to the debtor corporation, the trustee

¹⁷ *Ibid.*

if any, provided for in the plan, and the successor or transferee corporation. Within these limitations the section provided that "no income or profit, taxable under any law . . . shall . . . be deemed to have accrued to or to have been realized by . . ." the parties specified, and thus removed Chapter X transactions from incidence of the uncertainties characterizing the general "reorganization" provisions. One who followed the procedure could be assured he would not thereby run into tax consequences which would be worse than the economic illness requiring that cure.

As it was originally considered by the House Committee, the Chandler Act contained no counterpart of the present Section 270. Had Section 268 thus been left to stand alone, with no accompanying provision for "basis," either there would have been no applicable provision for "basis" or the general "basis" provisions would have remained applicable to Chapter X reorganizations falling within their terms, with the result that they would apply to some Chapter X reorganizations but not to others. The latter view apparently was generally accepted. Under it much of the previous uncertainty would have remained, but with its focus shifted from "realized income" to "basis." Moreover, it was the view of Treasury officials, apparently in the assumption of continued transfer of "basis" under the general provisions, that the effect of Section 268 would be to provide a double deduction in some cases,¹⁸ unless complemented by a corresponding "basis" provision, and thus be unfair to the revenue.

Accordingly the Treasury, and others, made various proposals,¹⁹ which eventuated in the adoption of Section 270 in its original form. This provided for transfer of basis, as did the code provisions, but required that it be decreased by the amount of the reduction of indebtedness, a measure at variance with the terms of the code. It was from the requirement of reduction, and the measure provided for it, that new difficulties were derived. Although the only occasion for making a further provision concerning basis arose from the adoption of Section 268 and although the legislative history discloses the purpose of Congress exactly contrary to placing Chapter X reorganizations at radical disad-

¹⁸ Hearings before the House Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess., 352-354; Hearings before Subcommittee of Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., 137-139.

¹⁹ See House Committee Hearings, 353-354; Senate Subcommittee Hearings, 145-146.

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vantage from others, the literal effect of the original Section 270 came near if not entirely to wiping out the whole benefit conferred by Section 268.²⁰ Soon it was realized that literal application of the specified new measure of reduction would require decrease of basis in many instances to zero or even to a point below zero, because the amount of the debt cancelled or reduced would equal or exceed the value of the property or that assigned to the basis transferred. Thus, any tax benefit derived from Section 268, in such cases, would be more than offset by the higher taxes resulting in later years from the absence of any depreciation base and in case of sale of the property acquired. And in cases where no benefit could be derived from Section 268, the effect of applying Section 270 was, if not to impose a capital levy,²¹ then to deny the new owners equal treatment, not only with other transferees under the code provisions, but with all other taxpayers.

could

Congress, in view of its original object in adopting Section 268, ~~cannot~~ possibly have intended such consequences for Section 270. The cure was worse than the disease.²² The legislative history gives the clear impression that adoption of the original Section 270 was a plain blunder, the consequences of which were not foreseen, understood or intended by those who finally gave it the form of law.²³

Legislative relief obviously was in order and was forthcoming at the next session of Congress, in the amendment of Section 270 adding the language giving it its present form.²⁴ The amend-

²⁰ H. Rep. No. 2372, 76th Cong., 3d Sess., 2-4; S. Rep. No. 1857, 76th Cong., 3d Sess., 15; Hearings before a special subcommittee on bankruptcy and reorganization of the House Judiciary Committee on H. R. 9864, 76th Cong., 3d Sess., 3, 5-11, 13-14, 16, 18-31, 54; cf. Paul, Debt and Basis Reduction under the Chandler Act (1940) 15 Tulane L. Rev. 1, 5.

²¹ Cf. Darrell, Creditors' Reorganizations and the Federal Income Tax (1940) 57 Harv L. Rev. 1009, 1016.

²² Paul, Debt and Basis Reduction Under the Chandler Act (1940) 15 Tulane L. Rev. 175.

²³ Hearings before the House Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess., 352-354; Hearings before Subcommittee of Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., 137-139, 145-146; Hearings before a special subcommittee on bankruptcy and reorganization of the House Judiciary Committee on H. R. 9864, 76th Cong., 3d Sess., 52-59, 66-67. A significant letter written by Congressman Chandler shortly after the passage of the Chandler Act was submitted at the 1940 Hearings (Hearings on H. R. 9864, at 52) and was received by the Subcommittee into the record. For some reason it was not published in the record, although the Chandler letter was referred to in a letter which was published (Hearings on H. R. 9864, at 56). The Chandler letter may be found in Banks, Treatise on Bankruptcy for Accountants (1939) 84-85.

²⁴ Cf. note 1 *supra*.

ment removed some, but not all of the uncertainty confronting Chapter X reorganizers. It placed a floor to the amount of reduction required. In no case would basis be reduced below fair market value. But this was only partial cure of the original infirmities. Above the floor, debt cancellation remained the measure of reduction, thus keeping Chapter X reorganizations generally at a disadvantage with those taking place under the code. But, what was more important, the chief hazard remained, namely, whether Section 270 was intended to operate only where Section 268 was effective to afford actual tax benefit or, as the Government contends, regardless of whether such relief was afforded. And in this case the hazard has been realized in assessment.

III.

With this background we turn to Section 276c(3). By their own terms Sections 268 and 270 apply only to transactions arising in connection with proceedings "under this chapter," that is, Chapter X of the Chandler Act. The instant transactions arose in proceedings, not under Chapter X, but under Section 77B, which had been closed by final decree March 1, 1937. The Chandler Act became effective September 22, 1938. Accordingly, Sections 268 and 270, of their own force, are not applicable to these transactions. If they are so at all it is by virtue of Section 276c(3), which the Government says must be construed to extend their operation retroactively to include these facts. This petitioner disputes.

The language immediately in question is the italicized part of subdivision (3), as follows:

(c) the provisions of Sections 77 A and 77 B . . . shall continue in full force and effect with respect to proceedings pending upon the effective date of this amendatory Act, except that

(3) sections 268 and 270 of this Act shall apply to any plan confirmed under section 77 B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77 B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan did for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient. [Emphasis added.] 52 Stat. 905, 11 U.S. C. § 676.

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Three constructions have been advanced. Shortly stated they are that Sections 268 and 270 apply to transactions involved in 77 B proceedings (1) only if the proceedings were pending September 22, 1938; (2) only for 1938 and later tax years, but including transactions in proceedings closed before September 22, 1938; (3) for all tax years from 1934 forward as to transactions in all proceedings in which a plan had been or should be confirmed, regardless of whether the proceedings were pending or had been closed on September 22, 1938.

The petitioner advances the first two views, alternatively; the Government the third. The Government interprets the italicized language as if it were wholly disconnected from and unrelated to the preceding portions of Section 276c, in other words, as an entirely independent provision unlimited by its statutory context. Petitioner, on the other hand, regards it as merely a part or phase of Section 276c,²⁵ and thus reaches the exactly contrary view of its meaning. The statute, it says, refers in the first paragraph of "c" to "proceedings pending" under 77 B and, to quote the brief, "exceptions (1), (2), and (3) are keyed into this first paragraph and refer to pending proceedings also. They merely except from the *pending cases* those to which 77 B is not to apply. Since (4) deals only with pending cases and not-closed cases, they refer also to pending cases." The Government concedes there is force in this view, though it suggests, we think untenably,²⁶ that the

²⁵ Petitioner's statement of the argument does not take account expressly of the obvious difference between what he calls "exceptions (1) and (2)," on the one hand, and "exception (3)," on the other. (1) and (2) are clearly true substantive exceptions to the general mandate of "c." That is, they provide instances in which Section 77 B shall not continue to operate, contrary to the general provision of "c" for its continued effectiveness in pending proceedings. Like effect however cannot be given to (3). It does not purport expressly to provide for nonoperation of 77 B. Rather its force is to provide for an extended operation of Sections 268 and 270, with reference to 77 B proceedings.

The formal difficulty however is more apparent than substantial. Nothing in (3) is at all inconsistent with its limitation to pending 77 B proceedings. And the formal connection with "c," though awkwardly made, affords some evidence of purpose to limit the effects of (3) to such proceedings. The same consequence, however, would seem to be dictated, if the formal connection as an "exception" to "c," were disregarded and (3) were treated as a separate subsection, like the corresponding provisions of other chapters. Cf. note 27 *infra*. The substantive relationship with the subject matter and purpose of the preceding provisions of the section as a whole would remain. Cf. text *infra* Part III.

²⁶ It is true petitioner did not present this interpretation in the Court of Appeals or in the Tax Court. It was advanced as a question presented on the petition for a writ of certiorari, the matter has been argued here, and

question is doubtfully open. The Court of Appeals accepted the Government's view, the Tax Court the alternative or second view advanced by the taxpayer. We think neither can be accepted and that the effect of Section 276e(3) is to confine the application of Sections 268 and 270, in 77 B proceedings, to proceedings pending when the Chandler Act became effective.

If Sections 268 and 270 were to be applied to all reorganizations completed under Section 77 B, literally they would cover all such transactions running back to 1934, when the latter section was enacted. As to proceedings closed when the Chandler Act took effect, this would involve disturbance of tax consequences already settled for five years, unless cases are excepted where the statute of limitations had run.²⁷ We have no means of knowing how much resurrection of old claims or generation of new ones in respect to settled matters this would create. Nor did the authors of the Chandler Act. But, from the circumstances of the time and the very necessities which brought about adoption of Section 77 B, the volume must have been considerable.

To construe Section 276e(3) to produce such consequences in no way would further the primary objects of Sections 268 and 270, which were to encourage use of Chandler Act procedures, at the same time preventing their abuse for tax advantage. Rather it would pervert those sections by changing their character, to the extent of their retroactive operation, from relief provisions to purely revenue measures of the worst type. In adopting them Congress was not uprooting the whole tax past of reorganized debtors and their creditors. It was, or purported to be, giving

the Government does not claim surprise. The issue of retroactivity and proper interpretation of Section 276e(3) has been a focal point of the controversy in the Court of Appeals and in the Tax Court. Petitioner has maintained throughout that there was no tax deficiency for either 1938 or any prior year. Thus the issue has been presented at all stages, although a theory to sustain petitioner's position concerning it has been advanced here which was not put forward in prior stages of the litigation.

It may be noted that the terms of Section 276e(3) make no provision concerning the statute of limitations. They apply literally to all prior 77 B proceedings. The Commissioner and the Treasury have not interpreted the section to make Sections 268 and 270 apply beyond the time when the general statute has run. But this interpretation is not necessarily controlling in the face of the breadth of the language used, if it is taken as unlimited by its context. No assessment was made in this case for 1934 because the petitioner corporation was not organized until 1935.

relief from harsh or uncertain tax consequences to persons reorganizing presently or in the future.²⁸

The language does not require such unlimited construction. The words are not directed expressly to past tax years. Nor are they focused upon transactions in closed proceedings. It is true that Section 276e(3), if construed as though it were entirely independent of the remainder of Section 276e, does not refer explicitly to *pending* 77 B proceedings, except in its concluding clause. Yet it is part and parcel of that section, which in all other respects deals only with pending and future proceedings, not with closed ones. And the concluding clauses of (3) afford additional evidence that it was intended to apply only to plans confirmed or to be confirmed in pending proceedings, as does also its setting in the context of Section 276 as a whole.²⁹

Thus Section 276, in subsections a, b and c [excepting only Section 276e(3)], deals exclusively with pending or future proceedings. Congress' concern in "a" was that Chapter X should

²⁸ Cf. Part II of this opinion.

²⁹ The section comprises the whole of Article XVI of Chapter X, entitled "When Chapter Takes Effect." It is as follows:

"Sec. 276. a. This chapter shall apply to debtors by whom or against whom petitions are filed on and after the effective date of this amendatory Act and to the creditors and stockholders thereof, whether their rights, claims, or interests of any nature whatsoever have been acquired or created before or after such date;

"b., a petition may be filed under this chapter in a proceeding in bankruptcy which is pending on such date, and a petition may be filed under this chapter notwithstanding the pendency on such date of a proceeding in which a receiver or trustee of all or any part of the property of a debtor has been appointed or for whose appointment application has been made in a court of the United States or of any State;

"c. the provisions of sections 77 A and 77 B of chapter VIII, as amended, of the Act entitled 'An Act to establish a uniform system of bankruptcy throughout the United States', approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

"(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

"(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; and

"(3) sections 268 and 269 of this Act shall apply to any plan confirmed under section 77 B before the effective date of this amendatory Act and to any plan which may be confirmed under section 77 B on and after such effective date, except that the exemption provided by section 268 of this Act may be disallowed if it shall be made to appear that any such plan had for one of its principal purposes the avoidance of income taxes, and except further that where such plan has not been confirmed on and after such effective date, section 269 of this Act shall apply where practicable and expedient." (Emphasis added.) 52 Stat. 995, 11 U. S. C. § 676.

apply notwithstanding the substantive rights of debtors, creditors and others had arisen before the effective date of the Act. In "b" it was that the pendency of bankruptcy and receivership proceedings should not defeat resort to the Chandler Act's provisions; in "c" it was with an accommodation of the provisions of Sections 77 A and 77 B and those of the Chandler Act as to pending proceedings. Apart from Section 276c(3), therefore, the whole problem treated in Section 276 was to give the Chandler Act as wide room as possible for future operation, notwithstanding the previous vesting of substantive rights or institution of bankruptcy or reorganization proceedings. Congress was concerned with the Act's future operation, as a remedial provision, not as a method of creating new and retroactive substantive rights and liabilities.

This being true, it is difficult to understand why Congress might wish to follow exactly the opposite policy with reference to newly created substantive tax rights and liabilities. It would seem wholly incongruous to imply such a purpose in the absence of language unquestionably requiring it, both as a matter of general legislative policy and, more especially, as one of accommodation with the purposes of the particular legislation. In short, apart from subdivision (3), relating to tax incidents of reorganization, all of Section 276 was devoted entirely to matters affecting pending and future proceedings. We can find reason for no other view than that this was true also of the provisions for application of the new tax features.

This is borne out by the concluding clauses of Section 276c(3) itself, which provide for exceptions to its operation. The second exception in terms relates only to pending proceedings. It contemplated future confirmation exclusively. The first exception, standing alone, literally could be applied in the case of a closed proceeding. But reaching such cases was not a necessary reason for including it. Such a reason existed, however, in the necessity for covering plans already confirmed in pending proceedings, unless parties then reorganizing under Section 77 B were to be treated differently from others reorganizing at the same time under Chapter X. The two exceptions thus dovetailed to provide complete coverage for disallowing the exemption given by Section 268 in pending proceedings. They comprehended distinct situations and

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provided different sanctions,³⁰ all however consistent with application only in pending proceedings. Thus the entire language of Section 276c(3) was capable of full and complete application, although confined to pending proceedings. To give it greater scope, retroactively, is required neither by the terms nor by the purposes of the specific provision or others related to it in context or by reference.

That the narrower application was the intended one seems most apparent when the nature of the problem with which Section 276c(3) sought to deal is considered. There was no problem arising from enactment of the Chandler Act, with reference to closed 77 B proceedings. And there was no reason originally when Section 268 stood alone, for giving the relief it afforded to taxpayers involved in such proceedings. Nothing in the legislative history of Section 268, or of Section 270, shows any concern, intent or occasion for dealing with such taxpayers. The whole desire related rather, as has been shown, to taxpayers who might be adversely affected by the general revenue provisions in taking advantage of the Chandler Act.

However, that Act itself created another problem, namely, how far its terms should apply in pending 77 B proceedings. Congress decided that the Chandler procedure should be followed as far as possible, though not to the extent of displacing the 77 B procedure in reorganizations far advanced.³¹ The same policy was framed for other chapters. Consequently Sections 276c(1) and (2) were included, as were also comparable provisions in other chapters.³² With them in, the problem was presented whether the Chandler Act's tax relief provisions, including Sections 268 and 270, should apply also in the pending 77 B proceedings and, if so, to what extent—only to those converted into Chandler Act proceedings by Section 276c(1),—or also to those partially converted under Section 276c(2) by an exercise of judicial discretion and those falling within 276c(2) but so nearly completed or otherwise situated that application of the Chandler Act in any respect

³⁰ I.e., refusal of confirmation where the plan had not been approved (cf. § 269) and disallowance of the tax exemption, if the plan had been confirmed. For tax purposes these come to the same result, a fact also indicative that both exceptions were intended to operate within the general limitation of pending proceedings.

³¹ S. Rep. No. 1916, 75th Cong., 3d Sess., 39; Hearings before the House Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess., 375-376, 383; Hearings before Subcommittee of the Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess., 6-7.

³² Cf. note 34 and text *infra*.

would be impracticable and therefore 77 B would continue exclusively effective.

Although these pending 77 B proceedings, and particularly those nearing completion, having been already begun, were generally without the scope of the encouragement Sections 268 and 270 were intended to give to persons contemplating reorganization, Congress undoubtedly felt it would be unfair to give the relief to taxpayers following the Chandler Act procedure, but deny it to persons following that of 77 B at the same time. To make this discrimination might force conversion of pending 77 B proceedings into Chapter X proceedings, solely on account of tax consequences, where but for them such conversion would not be proper or desirable. Accordingly, by Section 276c(3) Congress extended the tax relief provided by Sections 268 and 270 also to pending 77 B proceedings in order to put persons continuing 77 B reorganization on the same basis with others proceeding under Chapter X. There was no other occasion or object for the extension.

In view of these considerations, both of context and of consequence, we do not think Section 276c(3) can be regarded as applicable to closed proceedings. The purpose rather, as in the other provisions of Section 276, was to look to the future and in doing so to make the necessary adjustment, so far as was possible, between the provisions of the Chandler Act and pre-existing laws as to proceedings pending when the former took effect. Thus construed, Section 276c(3) becomes consistent, both in form and in the purpose and effects of applying the new tax provisions, with the other provisions of Section 276 and with the general policy of the Chandler Act as to applicability of its terms.³³ Any other view would make Section 276c(3) a unique provision in the statute's setting and one inconsistent with, if not also contradictory to, the Act's general purposes and the limited objects of the particular provisions immediately in issue.

Further support for this view would seem to be afforded, when the consequences of applying it or the contrary one to similar pro-

³³ "Except as otherwise provided in this amendatory Act, the provisions of this amendatory Act shall govern proceedings so far as practicable in cases pending when it takes effect; but proceedings in cases then pending to which the provisions of this amendatory Act are not applicable shall be disposed of conformably to the provisions of said Act approved July 1, 1898, and the Acts amendatory thereof and supplementary thereto." Act of June 22, 1938, c. 375, § 6b, 52 Stat. 940.

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visions appearing in other chapters of the Chandler Act³⁴ are taken into account. If those provisions are to be given retroactive application comparable to what the Government says should be given to Sections 268, 270 and 276e(3), the disruption of settled tax situations, by virtue of the Chandler Act's adoption, may be multiplied many times over what would follow from giving such an effect only to Sections 268, 270 and 276e(3). Although the immediate consequences of decision in this case are limited to the specific effects of these sections, it is at least doubtful that they could be given a different construction, as to retroactive application, from what might be given to the comparable sections of other chapters. The possibility that uniform interpretation may be required gives pause, at least, before adopting a view in this case which, if extended to the other provisions, would open so wide a door for retroactive taxation.

As against this interpretation, the Government's argument rests primarily on two bases: (1) that the words of Section 276e(3) require its construction; and (2) that unless this is given, discriminations as to tax consequences will be created between taxpayers involved in closed proceedings and those in pending and future ones, with the result that mere speed in getting the proceedings pending prior to September 22, 1938, to a final decree would determine whether taxpayers equally de-

³⁴ Chapters XI, XII and XIII deal respectively with Arrangements, Real Property Arrangements by Persons Other Than Corporations, and Wage Earners' Plans. Each of these chapters embodies sections corresponding in principle to Sections 268, 270 and 276. Those comparable to Section 276 are Section 399 in Chapter XI, Section 526 in Chapter XII, and Section 686 in Chapter XIII. Each, like Section 276, contains the whole of an article entitled "When Chapter Takes Effect." Each contains four subsections (with a fifth in Section 686), corresponding to subsections a, b, and c of Section 276 and subdivision c(5) of that section. Thus, Sections 399(4), 526(4), and 686(4), correspond to subdivision 276e(3). They differ from it however in that they are formally independent subsections, whereas Section 276e(3) is formally a part of Subsection 276e, dependent upon its general mandate, and thus, perhaps even more clearly limited by the preceding provisions. Cf. note 23 *supra*.

Sections 268, 270 and 276, therefore, do not represent isolated instances of legislation peculiar to corporate reorganizations under Chapter X. They are rather particular instances of a general pattern of legislation, relating to a common problem running through Chapters X, XI, XII and XIII, namely, to what extent the Chandler Act's terms should be applied to pending reorganizations, arrangements, wage earners' plans, etc. Because of detailed differences in the situations affected, the provisions corresponding to Sections 268, 270 and 276 vary somewhat in detail. But the similarities rather than the variations, whether in situation or in terms, are significant for present purposes.

serving would be afforded the relief provided by Sections 268 and 270.

The answers are obvious. In the first place, the wording of Section 276c(3) does not require the Government's construction. That view can be taken only if subdivision (3) is torn, formally and substantively, from its context in the statute and the problems with which these surrounding provisions, including Sections 268 and 270, undertook to deal. Thus to treat the provision not only would disregard the purposes of all these related provisions. It would convert subdivision (3), in its practical application, into an entirely independent tax measure, solely in the nature of an amendment to the general revenue legislation, and with the harshest retroactive tax consequences. This in fact seems to be the Government's view of the character of the legislation.³⁵ But that view wholly disregards the fact that neither Sections 268 and 270 nor Section 276c(3) had any purpose originally or later merely to produce larger revenues or to operate exclusively as revenue measures. It is true they modified the preexisting revenue provisions, so far as they were applicable by their terms to do so. But this was a function of their primary object, which was to give relief to parties undertaking reorganization, not simply to impose new and different taxes upon them, much less to do so with respect to transactions long since settled both as to taxes and as to reorganization. The objects of Section 276c(3) cannot be ignored or distorted by thus stripping the provision, formally and substantively, from its statutory setting and the limitations this clearly imposes.

So far as respects the Government's concern over the possible discriminations which will be created between taxpayers by ac-

³⁵ Thus, in its brief the Government asserts, concerning petitioner's argument that Sections 268 and 270 apply only to "pending" proceedings: "This contention, although plausible, neglects the fact that Sections 268 and 270 are essentially tax provisions." (Emphasis added.) To this it may be answered that the sections, from their origin, purpose and function were "essentially reorganization provisions" or, to put it differently, "essentially tax relief provisions." The Government's emphasis upon the sections as taxing measures ignores their primary object and function, which were to provide tax relief for parties undertaking reorganization and to prevent the clogging effects of the existing tax laws upon the operation of the Chandler Act. It also fails to note that retroactive application, in closed proceedings, could have no possible relation to the latter aim.³⁶ The matter is one of emphasis. But it is not permissible, in construing provisions designed to encourage reorganization, by giving relief from taxes, to take them by such an emphasis as if they were framed exclusively for raising revenue.³⁷

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ceptance of petitioner's view, it is perhaps enough to say that some such discrimination is inevitable with whatever solution may be accepted; and we think what follows from applying Sections 268 and 270 only to "pending proceedings" not only is preferable to any other but is most consistent with the normal course of legislation. Retroactivity, even where permissible, is not favored, except upon the clearest mandate. It is the normal and usual function of legislation to discriminate between closed transactions and future ones or others pending but not completed. The discrimination which the Government fears will follow from acceptance of the taxpayer's view admittedly will result. But it is one consistent with the normal consequences of legislation in the drawing of a line between the past or the present and the future. It also was one necessary for Congress to make if it were not to make another or others equally bad or worse. The Government's concern in this case is not that the taxpayer will suffer harsher discrimination under petitioner's construction than under its own. It is rather that he will not suffer it. For, as interpreted by the Government,³⁶ Sections 268, 270 and 276c(3) applied in conjunction would be much more likely to produce new, and retroactive, tax burdens than tax benefits. The present case is an illustration. To this the Government might be entitled if the statutory mandate were clear. It cannot have that advantage by dubious construction which ignores so much of the statute's setting, purpose and history. The letter does not require this. The consequences forbid it.

There remains for consideration the refusal of the Court of Appeals to reverse the findings of the Tax Court as to the original cost of the apartment building and the propriety of deductions claimed in 1937 for decorating expenses.³⁷ The Tax Court, in arriving at the cost of the building, refused to allow an alleged ten per cent contractor's commission paid to the debtor company's principal promoter and original sole shareholder because it was not convinced by petitioner's witness "that any amount was actually paid by the old company for contractor's services."

³⁶ That is, with Section 270 as operating independently of Section 268, to require reduction in basis even though no actual tax benefit has been derived under 268.

³⁷ Cf. text at note 8 *supra*.

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1 T. C. 163, 175. The Tax Court also concluded, after hearing vague testimony on two small deductions in 1937 for decorating and repairs, that these were not properly taken, because the same deductions for the same purposes had been claimed and allowed in 1936. These issues were well within the principle of the *Dobson* case. The Tax Court was upheld in these respects by the Court of Appeals and we accept these findings.

Accordingly, the judgments are reversed and the causes are remanded to the Circuit Court of Appeals for further proceedings in conformity with this opinion.

Reversed and remanded.